FUKUYAMA: *more right than he knew* (p. 373)

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MIROSLAW DZIELSKI

1942–1989

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Jeffrey Friedman

THE NEW CONSENSUS: I. THE FUKUYAMA THESIS

Fukuyama's argument that we have recently reached "The End of History" is defended against writers who fail to appreciate the Hegelian meaning of Fukuyama's "Endism," but is criticized for using simplistic dichotomies that evade the economic and ideological convergence of East and West. Against Fukuyama, the economic critique of socialism, revisionist scholarship on early Soviet economic history, and the history of the libertarian ideas of Rousseau, Kant, Hegel and Marx are deployed to show that history "ended" years ago: the creeds of the First and Second Worlds sprang from common assumptions; and even before Eastern European reform movements, both sides of the Iron Curtain had moved to economies that are neither capitalist nor socialist.

> A great democratic revolution is taking place in our midst; everybody sees it, but by no means everybody judges it in the same way.
>
> — *Tocqueville*

In revolutionary times like ours, it is hard to keep a critical perspective on the world. Even radical leftists have found it difficult to restrain themselves in the face of the collapse of Communism; thus, for every Daniel Singer fending off "The Specter of Capitalism,"[1] there is a Robert Heilbroner unabashedly announcing capitalism's "Triumph."[2] This puts much of the left in the same complacent posture as the right, effectively conceding, as Francis Fukuyama notoriously put it, "The End of History." So before Fukuyama's argument is forgotten, obscured by the misunderstandings of critics, it merits a more serious examination than it has received thus far. While Fukuyama was correct when, in responding to the criticism, he observed bemusedly that he had somehow managed to unite the political spectrum in the belief that he "was wrong and that

The author thanks Peter J. Boettke, Dallas L. Clouatre, Martin E. Malia, Milton Mueller, David L. Prychitko, Paul Rosenberg, Barbara Schwartz, Daniel Shapiro, David Ramsay Steele and Aaron Wildavsky for their sometimes vehement criticisms; the usual disclaimers apply.

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history has not in fact ended,"[3] in reality he also *expressed* a uniting consensus—which is why so many people who thought he was wrong bothered to pay attention to his argument in the first place.

It is this new consensus that was lost from sight in the thicket of responses to Fukuyama. For although he drew on ideas that are increasingly common to left, right and center, he did so in a way that was guaranteed to generate confusion. This was evident in the endless attacks against Fukuyama's alleged overoptimism. Thus, one Fukuyama critic deduced from "man's potential for evil" that "conflict," and thus history, will continue indefinitely.[4] A host of others sought to call Fukuyama's attention to such massive problems as entrenched poverty, starvation in the Third World, the continued possibility of non-Communist tyrannies, and most of all wars: civil wars, drug wars, maybe even nuclear wars.[5] Another, fresh from an encounter with the Sendero Luminoso guerillas, scoffed at the notion that ideological conflict has been superseded.[6] Some even chided Fukuyama for displaying neo-Marxist "eschatological hopes" in predicting history's end.[7]

Such criticisms missed the point. Neither Fukuyama nor his master, Hegel, claimed that history has *literally* ended; they did not say that "nothing will ever happen again."[8] Nor is "post-historical" reality "rational" in the sense that everything about today's world, or tomorrow's, will be perfect. Rather, Fukuyama argued that what is drawing to a close is history in the special Hegelian sense of the development of the idea of freedom (although Hegel and Fukuyama differ significantly over what freedom entails). Since, *ultimately*, reality reflects consciousness, the perfection of the "Idea" will eventually take substantial form in the real world of politics. In *that* way the world is rational—not because every aspect of it is reasonable by liberal lights.

As often as it was reprinted, the plain meaning of Fukuyama's thesis sentence was not well noted: "What we may be witnessing is not just the end of the Cold War, or the passing of a particular period of postwar history, but the end of history as such: that is, the end point of mankind's *ideological evolution* and the universalization of Western liberal democracy as the *final form of human government*" (emph. added). Again, Fukuyama admires Alexandre Kojève because he "sought to resurrect the Hegel . . . who proclaimed history to be at an end in 1806. For as early as this Hegel saw in Napoleon's defeat of the Prussian monarchy at the Battle of Jena the victory of the ideals of the French Revolution. . . . The basic *principles* of the liberal democratic state could not be improved upon"[9] (emph. in original). Far from the preposterous notion of the end of *news* attributed to him by his critics, Fukuyama made the plausible claim that the Idea of

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individual liberty (which he equated with liberalism) has triumphed, in the sense of being well on the road to victory, even though "at the end of history it is *not* necessary that all societies become successful liberal societies . . . " (emph. added). What matters is that all regimes will some day "end their ideological pretensions of representing different and higher forms of human society." But "this does not by any means imply the end of international conflict *per se*."[10] The end of history does not mean that there will be no more of the things about which historians write, nor even that there will be no more illiberal politics or ideas; it does mean, however, the death knell for such ideas.

It was not only the Hegelian form of Fukuyama's argument that accounted for the misunderstandings of it. For one thing, a great deal of "The End of History?," as befitted the reflections of a U.S. State Department officer, focused on the implications of the end of history for international relations; this misled many readers into thinking that Fukuyama took the end of the Cold War to be equivalent to the end of history, which would indeed be silly. Much more important than that problem, however—although not unrelated to it—is that Fukuyama equated "the West" with liberal individualism in contrast to the East and Communism.[11] Here he brought foreign policy to the center of his argument by adopting Cold War antitheses that have scant philosophical meaning: not only is Communism as "Western" as liberal individualism, but it is genetically and ideologically closer to liberalism than Fukuyama's schema permits it to be. To penetrate to the valid core of Fukuyama's message requires dispensing with the false dichotomy that led him to believe that the "end" of history has only been secured now, with the disintegration of Communism, rather than, as in the Kojèvean-Hegelian original, in the nineteenth century, when the ideas common to liberalism and socialism alike vanquished their opponents.

Similarly, to the extent that economics can be isolated from ideology and politics, the Communist, centralized, "command" economies may not be quite so different from the "capitalist," market-based economies as Fukuyama, and the new consensus he represents, assume. According to Fukuyama, "the deep defects of socialist economies were evident thirty years ago to anyone who chose to look." Now that the failure of socialism has penetrated the realm of consciousness, socialist nations are "mov[ing] away from central planning."[12] Indeed, it was the appearance of Fukuyama's article in the midst of the worldwide turn toward "market-based economies" that gave it much of its resonance. But there has been a remarkable lack of curiosity about exactly *why* socialism has been a bust. Like Fukuyama, most observers of the "triumph of capitalism" have done

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little more than gesture vaguely at the inflexibility, mismanagement and lack of work incentives of what the left calls "real, existing socialism." These explanations are valid as far as they go, but they sound for all the world like criticisms of the "capitalist" United States made by those concerned about its economic competitiveness—critics who usually favor the opposite of the decentralization recommended for Eastern Europe: "industrial policy," or central planning. An explanation of socialism's "deep defects" ought to offer insight into capitalism as well as its antithesis. But such an explanation, which would afford us a better critical vantage point on the economic dimension of the collapse of Communism, might blur the sharp divide between capitalism and socialism implicit in Fukuyama's consensus worldview.

On the other hand, there is one respect in which Fukuyama is certainly correct. That is the triumph of the ideal of constitutional, representative democracy over single-party totalitarianism[13] (a development to be explored in the second part of this article, which will appear in the next issue). Although neither Fukuyama's argument nor empirical reality lend themselves to neat distinctions between "economy," "polity" and "ideas"—especially when Communist states that deliberately unite the three are in question—such distinctions are essential if we are to analyze and compare different societies. Unless we believe that state socialism, totalitarianism and Marxism are so inextricably linked that they cannot even be conceptually separated, then we can say that Fukuyama is unambiguously right about the victory of democracy over totalitarianism, but not about the victories of capitalism and individualism over socialism and Marxism. Yet even where he is wrong, it is only because Fukuyama does not take his argument far enough. There is reason to believe that the very different triumphs of capitalism and individualism occurred well before Fukuyama allows. While this would mean that Fukuyama is even more right than he realizes, it would also mean that he, and the new consensus, seriously misunderstand the nature of the post-"historical," liberal world we now inhabit.

Did History "End" in 1921?

To state the most controversial revisionist conclusion first, economically, "the end of history" occurred sixty-nine years ago in the Soviet Union. On March 15, 1921, with his "Report on the Substitution of a Tax in Kind for the Surplus Grain Appropriation System to the Tenth Congress of the Russian Communist Party (Bolshevik)," Lenin undertook a New

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Economic Policy of economic liberalization—the reintroduction of the market. Before NEP had come three years of what was later called War Communism; but for reasons that were just becoming clear to some economists, War Communism was a debacle that forced Lenin to retreat to a highly interventionist market economy. The civil war that followed the Russian Revolution is usually blamed both for the initiation of War Communism and for the economic devastation of the period. But in these pages[14] the ideas of the economists who were contemporary critics of socialism have been taken up in order to argue that the calamitous initial period was less "war" Communism—imposed (and defeated) by civil strife—than it was the closest the world has come to true socialism: the deliberate replacement of private property and the economic market by conscious, collective planning.

In Lenin's words, War Communism was "a direct transition from the old Russian economy to state production and distribution on communist lines," a transition that produced such disastrous results that it had to be (temporarily) abandoned.[15] Although one could hardly expect him to have a firm grasp of *why* War Communism failed, Lenin leaves no doubt that in his mind, it did fail:

> In attempting to go over straight to communism, we, in the spring of 1921, sustained a more serious defeat than any defeat inflicted upon us by Kolchak, Deniken or Pilsudski. This defeat was much more serious, significant and dangerous. It was expressed in the isolation of the higher administrators of our economic policy from the lower and their failure to produce that development of the productive forces which the Programme of our Party regards as vital and urgent.[16]

The best summary of the leadership's view of War Communism, though, must be Trotsky's:

> How did we start? We began . . . in economic policy by breaking with the bourgeois past firmly and without compromise. Earlier there was a market—we liquidate it, free trade—we liquidate it, competition—we abolish it, commercial calculation—we abolish it. What to have instead? The central, solemn, sacred, Supreme Economic Council for National Economy that allocates everything, organizes everything, cares for everything: where should machines go, where raw materials, where the finished product—this all will be decided and allocated from a single centre, through its authorized organs. This plan of ours failed.[17]

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Thus ended socialism, in the revisionist view. What followed, with Stalin's introduction of Five Year Plans, had little to do with either Marxism or socialism (although it seemed to be as close to Marxism and socialism as one could come without repeating the experience of War Communism). Stalin did not abolish commodity production for profit, or monetary exchange, as Marxism demanded;[18] nor did he equalize class relations or incomes, even very roughly, as egalitarian versions of socialism would have entailed. Instead, he thoroughly statized the economy. Stalinist etatism was animated by the Leninist tenet that the Communist Party was the vanguard of the revolutionary proletariat. Party dictatorship, with the attendant privileges for Party members, was imposed on a stripped-down *market* economy, resulting in a market shaped by, suffused with and nearly overwhelmed by Party-state interventionism, a market hidden under, distorted and virtually destroyed by an ideological and institutional veneer of socialism—capitalism with a bureaucratic face.

This is, I realize, an audacious, even fantastic conclusion. It not only strikes at several ideological sacred cows—e.g., the right's celebration of the East Bloc's disintegration as signifying the failure of socialism—it bumps up against common sense, too. How can it be said that economies in which entrepreneurship and private ownership of the means of production are largely forbidden, in which there are no stock or futures markets, in which central planning bureaucracies determine what economic activity is to occur, in which the monopoly political party-cum-state appoints the personnel who staff productive enterprises—and in which daily life is a desperate struggle to find what has not been produced and to make do with what has—how can such economies possibly be called "capitalist"? I admit that the revisionist argument is troubling: it threatens to trivialize the meanings of "capitalism" and "markets" by universalizing them.

But it would be a mistake to let matters rest there, with an impressionistic, though deeply plausible, rejection of the revisionist argument. Peter Berger, in his recent exercise in comparing capitalist and socialist societies, has pointed out the need to indulge counterintuitive hypotheses in addressing the difficult issue of defining capitalism and socialism:

> It is of the essence of the human mind to take apart what experience presents as a whole. . . . Any attempt at understanding or explaining a human "world" necessarily entails an intellectual task of disaggregation. The purpose of this is not to deny the richness or wholeness of human experience but rather to grasp the latter within an intellectually meaningful

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> framework. The enterprise known as "theorizing" in any science is, of necessity, an operation whereby empirical aggregates are disaggregated in the mind and whereby the resulting elements are then ordered in terms of some sort of causal or functional or hermeneutic hierarchy. . . . In America, "capitalism" appears inextricably linked with the material cornucopia of an advanced industrial civilization, with a highly dynamic class system, with political democracy, and with an array of cultural patterns (for example, "individualism"); yet each of these can be seen as being distinct from the economic arrangements as such.[19]

Surely now, with the demise of the Cold War, we can allow ourselves the latitude to "disaggregate" the familiar conceptual unities to which we have become accustomed?

The revisionist theory of "socialism" presented here does not deny any of the obvious structural, ideological or material differences between the First and Second Worlds. In fact, it seeks to understand those differences better by accounting for empirical and theoretical anomalies within the conventional picture of the First World as capitalist and the Second as socialist. The revisionists highlight one such anomaly: the persistence of market elements within "socialist" economies. But that is not the only anomaly created by the hard and fast capitalist/socialist dichotomy.

For instance, there is also the fact that, to quote Berger again, "what Joseph Schumpeter called the 'tax state' has massively introduced political allocation as a very important factor in the economies" of the West.

> There can be no doubt that no society commonly classified as capitalist (including all of North America and Western Europe) remotely resembles what Adam Smith would have recognized as a "free" society. In other words, in these societies mechanisms of political allocation are constantly intervening to modify (the critics would say distort) the working-away of the market.[20]

Critics of the tax state—more broadly, the interventionist welfare state—are opponents of the economic irrationality, the inefficiency and expense, the poor service, inflexibility and bureaucracy they attribute to the Western public sector. Recalling that these complaints parallel the consensus view of what is wrong with *socialism*, might it not be valuable to compare the performance of First World and Second (and Third) World public endeavors? Such a comparison is, strictly speaking, impermissable if we insist that Western "capitalism" is fundamentally distinct from Eastern "socialism" (only likes can be compared). Consequently, no

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serious analyst of the two systems, such as Berger, maintains that distinction consistently.

Now let us return to the similar situation regarding the nature of really existing socialism. Serious students of the "socialist" economies admit that

> market mechanisms continue to interfere with the carefully laid plans of socialist command economies (from the viewpoint of orthodox ideologists in those places, to subvert socialism). Thus even the Soviet Union, not to mention other, less stringently controlled, socialist societies, gives ample leeway for enterprise oriented toward market profits. Some of this is legal (as the private plots on collective farms), much of it is illegal (the flourishing black market in "socialist property," much of it diverted ingenuously from the official economy by countless little underground entrepreneurs). . . . Market mechanisms have an apparently invincible way of creeping in. Indeed, given the intrinsic problems of socialism as an economic system . . . the question may be raised whether socialist economies could survive at all without these modifications by "creeping capitalism."[21]

The most widely recognized deviations of Second World economies from socialism—the underground economy and limited private enterprise, especially in agriculture—have in common that they are obvious departures from the ideal of public ownership. The revisionists, starting with Michael Polanyi, have pointed to more subtle deviations from socialism within the working of the official, public, centralized economy. Don Lavoie, for instance, contends that in "command economies," command is a dream belied by the nightmarish reality:

> The plan in actual practice is shaped by a variety of independent decisions made by plant managers (and at least partly in terms of profit-and-loss accounting), which are passed up the planning bureaucracy, where they are used to produce aggregate statistics called "the plan." These originally disaggregated decisions are then passed back down the bureaucracy, returning to the disaggregated level in the form of targets. The aggregate figures for making up the plan . . . are quite useless for any real decision-making. When those in political command do interfere with plant managers' decisions they are not controlling the economy, but taking blind and arbitrary actions whose consequences are unpredictable.[22]

Polanyi put it this way: "The Five Year Plans with all their sound and fury are but the parading of a dummy dressed up in the likeness of the original purpose of socialism." He pointed out that because of the way "central

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planning" actually worked, even under Stalin, the official economic textbook

> is in two parts, nicknamed by Soviet students the Old and New Testament. The "Old Testament" tells you all about the evils of commercialism, of production for profit, of the fetishism of commodities, of social relations being degraded to relations between goods, of the alienation of man within an acquisitive economy producing for the market. In the "New Testament" each of these commercial features is reintroduced, with each time renewed apologies, explaining that under socialism they are really and essentially different from what they were before, and that besides they are only temporary, etc., etc.[23]

The gap between the ideal of central planning and its reality has moved such analysts as Alec Nove to conclude that "centralized planning has not existed because it *could* not exist."[24] But even apart from problems of central planning of the kind discussed by the revisionists, it could be argued that the critical role of the legal and illegal private sectors in the Second World undermines the legitimacy of the "socialist" label usually applied to it—and that, conversely, the importance of the Western public sector calls into doubt the "capitalist" label applied to the First World. None of this is to deny the many differences between the two Worlds, but to reconceptualize them. Specifically, the revisionists do not claim that in backing away from the pure, ideal-typical socialism of War Communism, Lenin conceded the permanent need for capitalism, or that later, Stalin secretly knew that his economy depended on a market substratum. Their argument does not turn on motives or dispute the many important differences between East and West. But it does take account of the glaring problems with the conventional *interpretation* of those differences, so that East-West continuities are not overlooked in favor of the all too evident differences.

Or Was It 1920?

The anomalies that lend urgency to the revisionist reconceptualization of the history and status of socialist economies, however, are admittedly less often empirical than theoretical. For from Polanyi to Lavoie and beyond, the revisionists have been proponents of the economic critique of socialism that was simultaneously made, during the year before NEP, by

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Max Weber in Germany, Boris Brutzkus in Russia, and most comprehensively Ludwig von Mises in Austria.[25]

Without private property that can be freely exchanged, they argued, there would be no capital goods prices to provide participants in a socialist economy the information they need to make rational economic decisions. For only prices generated by the free exchange of private property allow people to calculate the most efficient use of scarce economic resources, based on the supply of and demand for them. Such calculation is what enables people to "orientate [themselves] properly among the bewildering mass of intermediate products and potentialities of production." Without it, the human mind "would simply stand perplexed before the problems of management and location." Mises asked his readers to

> picture the building of a new railroad. Should it be built at all, and if so, which out of a number of conceivable roads should be built? In a competitive and monetary economy, this question would be answered by monetary calculation. The new road will render less expensive the transport of some goods, and it may be possible to calculate whether this reduction of expense transcends that involved in the building and upkeep of the next line. That can only be calculated in money. . . . Where one cannot express hours of labour, iron, coal, all kinds of building material, machines and other things necessary for the building and upkeep of the railroad in a common unit it is not possible to make calculations at all. . . . Calculation by exchange-value makes it possible to refer values back to a unit.[26]

Absent the ability to make economic calculations based on exchange value (market pricing), nobody would know what factories and other forms of capital goods to build: there is no substitute for knowing which investments would be profitable. Without that criterion, huge sums would be wasted on technologies which used resources that the members of society, taken collectively, wished to be conserved in relation to the resources required by alternative technologies. When building a railroad, it may be that diamonds would be the best material to use for rails, considered purely from a technological standpoint. But in the real world of limited resources, the costs of using diamonds for rails instead of for something else, as compared to using one of a variety of grades of steel produced by various techniques with various degrees of efficiency and shipped from various locales, must be weighed in order to avoid wasting resources. There is no other way of doing that weighing than by using prices that reflect supply and demand inasmuch as they facilitate the sale of capital goods from one private owner to another. To eschew the only means of economic calculation would throw any advanced economy into chaos.

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As Mises put it, socialism is impossible, in the sense of being incompatible with anything but a primitive and impoverished level of economic activity.

The economic critique of socialism made it predictable that the Soviet experiment with "war" Communism would fail, and that a retreat would have to be made—as it soon was. Had the economic critique gained currency, it would not have been possible for the West to accept so unreservedly the subsequent self-depiction of the Stalinist East as "socialist." For although the economic critique goes a long way toward explaining the deficiencies of really existing socialism, it implies that socialism *must* be less than fully implemented in any advanced economy that manages a reasonable amount of production for social use—as the socialist economies must be admitted to do.

It was ironic, then, that even those who best understood the critique, Mises and his student F.A. Hayek, were unable to resist the Manichean cast of mind that later came to characterize Cold War perceptions of the Stalinist East (and that survives in the Fukuyama thesis). Implicit in their work during the Stalinist era (notably Mises's *A Critique of Interventionism* [1929] and Hayek's *The Road to Serfdom* [1944]) was a retreat, of sorts, from Mises's impossibility thesis, inasmuch as they now began to warn that the great choice was between socialism and the market economy—as if the former, far from being an impossibility, now existed in Russia. Polanyi recognized the irony:

> Of all the intellectual triumphs of the Communist regime—and they are vast—it seems to me the greatest is to have made these eminent and influential writers so completely lose their heads. Could anything please that regime better than to hear itself proclaimed by its leading opponents as an omnipotent, omniscient, omnipresent socialist planner? This is precisely the picture of itself which the regime was so desperately struggling to keep up.[27]

On the other hand, those theorists who did (and do) reject the characterization of Communism as socialist were entirely innocent of the economic critique. These "humanist" socialists—who legitimately trace their paternity to Marx[28]—oppose state centralization. But they have never satisfactorily answered the question of how economic cooperation between decentralized socialist units could occur without degenerating into either central planning or capitalism.[29] Although morally opposed to really existing socialism, they do not have a practicable socialist alternative to offer.

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In analyzing socialism, we are faced with this dilemma. The economic critique of socialism predicts the incompatibility of socialism and an economy that has moved beyond barter. But there are, or were until recently, dozens of apparent refutations of this thesis, in the form of the existing socialist economies. Therefore, either the economic critique is wrong, or real existing socialism is not really socialist. The aforementioned empirical anomalies suggest that the latter is a distinct possibility. Those who select the former option—unless they are the most positivistic of empiricists—assume the obligation of coming to grips with the economic critique, rather than dismissing or ignoring it—a task that has yet to be accomplished.[30]

The New Convergence

The most misleading passage in Fukuyama's article is this one:

> . . . the century that began full of self-confidence in the ultimate truth of Western liberal democracy seems at its close to be returning full circle to where it started: not to an "end of ideology" or a convergence between capitalism and socialism, as earlier predicted, but to an unabashed victory of economic and political liberalism.[31]

For in reality, Fukuyama is one of the most important convergence theorists of our time. In his thesis, East and West, left and right have not only converged, but imploded. Fukuyama has articulated not just the end of the ideological competition of capitalism and socialism, but the dialectical transcendence of their antithetical principles in the Kojèvean "universal homogenous state": the interventionist democratic welfare state that monopolizes the Western political scene. For it is that state—which allows the market to exist while intervening in its operation and sustaining itself at its expense—that, at least in the consensual view, combines the dimly understood but patently obvious advantages of economically self-interested capitalism with the compassionate regulation urged by socialists. And so, now that more noble experiments have been found wanting, we have made our way to the ultimate institutional development: the kind of state that has proven impervious to conservative challenges over the last decade, the state toward which all the nations of Europe except, at this writing, Albania are headed, the state to which such leftists as Heilbroner[32] and Agnes Heller and Ferenc Fehér,[33] and even putatively

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fundamentalist Marxists like Singer, are now pledging their only slightly qualified allegiance.[34]

The problem with this is that socialism was attempted by Lenin, not Stalin,[35] its defeat had far worse results than the dreary and exhausting decay of contemporary Eastern Europe, and a rudimentary market was in place long before Mikhail Gorbachev was born. If these revisionist claims are valid, then what has recently failed in Eastern Europe is not actually socialism, but a disastrously pervasive system of socialist-inspired interventionism, and in economic terms, the movement toward *interventionist market* economies cannot be considered a qualitative break with the past. This holds despite the enormous significance of the "quantitative" changes that may be in the offing, especially for the lives of those in the Second World. And it holds despite the fact that those changes are bound up with the extent to which the dictatorship of the Party is abolished, which will itself make a huge difference in Second World conditions—political, personal and economic.

On the other hand, if the Western economies are themselves interventionist, although not nearly to the same degree or in the same way, then it makes no more sense to insist on the recent victory of "capitalism" than on the recent defeat of "socialism." The success of the market seemingly depends on the nature and degree of the intervention imposed on it. There are not two choices, capitalism and socialism, but two poles, with a vast continuum of interventionism in between (determined, in part, by the democratic or authoritarian nature of the political structure generating the interventions). The economic triumph of the West amounts to a rightward jump along that spectrum by the East.

While this view of things is not revolutionary, and may even seem compatible with Fukuyama's liberal triumphalism,[36] the difference between a world of bipolar competition and bipolar continuities is important. It spares us the smug assurance that *directional* matters have been decided—which is what the end of history thesis claims. For while it may indeed be settled that we shall never try true socialism again, and that we shall not even indulge the Communist trappings of central planning, it is not at all clear that a leftward movement toward the substance of Communist interventionism has been ruled out: so little has the question been studied that we are not even certain in what that substance consists.

We do not even know whether it is fair to say that the poles of the continuum are real options or unattainable ideal types. Does the dependence of capitalism on a legal framework mean, as is commonly asserted, that true laissez-faire is impossible—just as the dependence of advanced societies on economic calculation makes socialism impossible? Or by

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progressively repealing interventions in the market, could laissez-faire be attained? By the same token, should absolute socialism be considered the logical outcome of interventionism, so that enough interventions would eventually add up to socialism and its attendant disaster? If so, when does that point arrive? There is, evidently, no inevitable "road to serfdom," but are there highway markers toward which welfare states should remain vigilant?

Elsewhere in this issue of CRITICAL REVIEW, the interventionist state is addressed on what is often considered its strongest ground: macroeconomic policy. Some of the neo-liberal writers argue that central control of money is akin to central planning of an entire economy without benefit of prices. Does this mean that such interventions as central banking, which are practiced in interventionist states East and West, are bits of true socialism, particles of anti-capitalism in conflict with the capitalist universe in which they subsist? Or does the fact that they are able to draw, in part, on the prices generated by the broader market make them qualitatively different from pure socialism? These are not mere theoretical concerns. When, as in recent years, the interventionist state, particularly in its macroeconomic aspect, seems to be performing well, does this show that we have found the "right" point on the interventionist continuum—an issue of practical political significance? One cannot answer that question, except through the most vulgar empiricism (either "If it ain't broke, don't fix it" when times are good, or "The whole system is rotten, throw it out" when they are bad), without understanding how the continuum works. But this enormously important issue has not been much addressed, except insofar as Mises and Hayek have discussed the logic of a certain kind of interventionism: price controls, which clearly do resemble socialism by hindering economic calculation. But what about taxation to finance an enormous network of welfare services, or the host of regulations of the market that impose and redistribute a vast array of costs? Both of these forms of intervention are reflected in uncontrolled prices; how does this affect our understanding of the interventionist continuum?

A great deal of neo-liberal thought has been devoted to analyzing socialism; now that socialism is, for the most part, considered "obsolete," perhaps that analysis can be integrated with the even larger body of neo-liberal economic criticisms of the particular interventions that suffuse the Western economies, resulting in a new framework for understanding the welfare state. Such analysis might explain the similarities between the economic problems of the East and the West as a function of interventionism, and explain the differences by distinguishing interventionism's

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degrees and types. It may well be that we conclude that the same logic that makes socialism fail applies to interventionism, too, so that stopping at a point to the right of really existing "socialism" does not rid an economy of the Eastern Disease, but instead ensures a milder case of it. Or it may enable us to distinguish types of intervention that are *not* similar to those that have proved counterproductive in "socialist" states, and are, therefore, to be given the benefit of the doubt when practiced in the West.

For the most part, this work remains to be done. Its neglect by most neo-liberal economists may be explained by their conviction that the welfare state already stands condemned on non-economic grounds, obviating the need for a comprehensive theoretical analysis. If there is a compelling *moral* critique of intervention based upon absolute rights of private property ownership, which renders economic criticism of interventionism superfluous (although not quite unimportant, apparently), then why do we need to devote serious attention to elaborating a new theory of the welfare state? (But by this logic, why do we need to worry about economics at all?) This self-satisfied mindset both encourages knee-jerk neo-liberal anti-statism, and, at the same time, hinders the development of a comparative theory of interventionism that might assume the critical role that many neo-liberals think is served by inadequate theories of natural rights.

In calling the natural rights-based, moral critique of the welfare state inadequate, I do not necessarily mean that it is invalid. I do mean that it is not persuasive to most people, and that it is not likely to become persuasive any time soon. This is, ironically, because Fukuyama is right in seeing contemporary history as a confirmation of the Hegelian picture of the course of modern consciousness. Thus far, I have argued that Fukuyama implicitly employs a careless dichotomy of capitalism and socialism in order to conclude that there is such a thing as a fundamentally different socialist system that is now in disarray. Next, in the realm of the history of thought, I shall contend that his simplistic antithesis of liberalism against Marxism leads him to believe that a fundamentally anti-libertarian system of ideas is now in retreat.

In both realms, the victory of the West came earlier and more completely than Fukuyama allows. Yet in both cases this means that what he portrays as foreign threats that have now been put to flight are in reality powerful tendencies within Western liberalism that have yet to be quieted, or even fully appreciated.

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The Progress of the Idea

Strictly speaking, Fukuyama never departs from the Kojèvean-young Hegelian notion that history ended in 1806. *Very* strictly speaking, of course, in the Hegelian system history "ended" the moment it began: its culmination in a free society was foreordained by the nature of the World Spirit, and was no more in doubt in 1517 or 1618 than in 1806 (or 1989). The practice of attaching a date to the end of history serves merely to highlight the substantive character of human progress. Singling out the Battle of Jena is intended to signify the defeat of the forces of hereditary privilege by those of individual freedom. In the modern era we have become conscious that all human beings are equally free; the state that embodies that realization concretely is the endpoint of ideological and political development.

Now, Fukuyama uses the fall of Communism to signify the final triumph of liberal democracy. But he does not consider the end of Communism to be part of the dialectical process in which each manifestation of the Idea is transcended—negated yet *preserved*—in the higher synthesis that supplants it. Instead, Marxism was "a 150-year detour" which, now that it is essentially over, should make us "reconsider whether Hegel was not in fact right in seeing the end of history in the liberal-democratic states of the French and American revolutions."[37] By a detour, Fukuyama means a dead end.

As much as one may deplore the results of Marxism in practice and relish the fall of the tyrannies that governed in its name, one cannot share Fukuyama's judgment of it as a theory. As with the notion of the recent victory of capitalism over socialism, the hiving off of Marxism as an ideological movement separate from the Western mainstream obscures the continuing tensions within the liberal consensus.

The alternative to dismissing Marxism as an inexplicable tangent is to recognize it as one of the incarnations of the triumphant Idea of freedom. In what follows, I postpone consideration of Marx's responsibility for Leninist dictatorship. The question at hand is whether Marxism's driving impulses can be written off as irrelevant to the "post-historical" world.

In that regard, the most important consideration is that Marxism sprang from the tradition of positive liberty that began with Rousseau. Positive libertarianism is not only, as a product of French and German thought, indisputably "Western"; it is intimately tied to liberalism, because it shares the libertarian impulse while addressing the paradox at the heart of the liberal idea of negative liberty, or liberty as freedom from coercion. For negative liberty guarantees the freedom to take "actions which are

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wilful, perverse and even consciously irrational."[38] But this entails that there is something moral about not interfering with immorality. Thus neo-liberals, who uphold one version of negative libertarianism, often argue that it is right to allow what might be considered immoral—say, withholding aid from the poor—because it would be a greater wrong to forbid it by violating individual property rights.[39] But this assertion must, in turn, rest on theories of the derivation and justification of those rights that, as I shall argue below, seem not only unconvincing, but positively self-contradictory to those who are not already neo-liberals.

Rousseau's solution to the paradox of negative liberty was Stoic in inspiration. The Stoics argued that no rational person would do what is wrong, and that no person under the influence of irrational influences can be considered free. Morality equals rationality, and rationality equals freedom. Therefore, true freedom is the freedom to do what is right. To Rousseau, although "man has no innate knowledge of" good, "as soon as his reason leads him to know it, his conscience impels him to love it: it is this feeling that is innate . . . relative to his species. . . ."[40] Consequently, man can do evil only when compelled to by his selfish appetites (despite the fact that even under such compulsion, his will remains free, in the more usual sense of undetermined by *external* forces).[41]

> As I meditated on the nature of man, I seemed to discover two distinct principles in him. The first elevated him to the study of eternal truths, to love of justice and moral beauty, to those realms of the intellectual world that the wise delight in contemplating. The second drew him downward into himself, subjected him to the power of his senses and the passions that are their ministers, and counteracted, through them, everything inspired in him by the first principle. . . . Man is not one; I both exert my will and fail to exert it; I feel both enslaved and free; I see what is good, I love it, and I do evil; I am active when I listen to my reason and passive when I am carried away by my passions. . . .[42]

Libertarian thought had grown out of the religious warfare that decimated sixteenth- and seventeenth-century Europe. Freedom of conscience was taken up by religious minorities as a means of self-defense. But, given the libertarian implications already inherent in Protestant doctrine (and, I shall contend below, in Christianity itself), the argument for religious liberty was destined to assume greater scope, leading to the notion that it was wrong per se for government to interfere with people's freedom. Non-consequentialist, deontological versions of *negative* libertarianism stop there.

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Rousseau, however, took the idea of freedom seriously enough to ask, in effect, whether stopping there was justified. I say "in effect" because as we shall see, rather than rejecting negative liberty, he remained committed to it, even though his idea of positive liberty led logically to the possibility of overriding negative liberty in order to "force people to be free," i.e., to do what is right. As Ernst Cassirer put it in his classic study of Rousseau, "real freedom . . . consists in tying all men to the law. And only then will they have become individuals in the higher sense—autonomous personalities."[43] This is because the alternative to obeying the (rational) moral law and doing what is right is obeying one's (irrational) appetites, which is tantamount to "slavery."[44] In human society, the moral law is contained in the "general will" of the sociable "species," which seeks the common good; true freedom consists in obeying the general will.

The influence of Rousseau's doctrine on Kant, whose study was adorned only by a portrait of Jean-Jacques, is clear. Kant's moral philosophy has as its starting-point the insistence that "inclination," i.e., appetite or self-interest, has no ethical standing, and that only obedience to a moral law derived from the nature of reason itself in complete disregard for such inclination counts as morality. "Since I have robbed the will of every inducement that might arise for it as a consequence of obeying any particular law, nothing is left but conformity of actions to universal law as such, and this alone must serve the will as its principle." Obedience to the rational moral law is true freedom: "Inclinations themselves, as sources of needs, are so far from having an absolute value to make them desirable for their own sake that it must rather be the universal wish of every rational being to be wholly free of them."[45] In sum,

> Will is a kind of causality belonging to living beings so far as they are rational. *Freedom* would then be the property this causality has of being able to work independently of *determination* by alien causes. . . . Thus a free will and a will under moral laws are one and the same.[46]

Similarly for Hegel, who sought to correct Kantianism, "What counts in a state is the practice of acting according to a common will and adopting universal aims. . . . Whims, lusts are not valid. . . . Only the will that obeys the law is free, for it obeys itself. . . ."[47] Hegel's metaphysics is but a theological version of positive freedom, yet is in a sense more realistic than the doctrine was in Rousseau and Kant, since positive freedom is in Hegel's thought a gradual development of cultural evolution rather than something to be instilled, as in Rousseau, by a "civil religion" or, as in Kant, presumably, by the writings of moral philosophers. Hegel makes

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imperfect reality, i.e. human history, literally the result of God's self-alienation as finite, mortal, particularistic, amoral/immoral necessity, on His way toward an enriched self-consciousness of His true identity as infinite, immortal, universal moral Freedom. God uses the "cunning" of the historical dialectic to produce, out of the self-interested passions of world-historical figures, the emergence of His own Idea: Reason or Freedom as embodied in an ethical society.

Marx's materialistic "inversion" of Hegel managed to preserve the positive conception of freedom. His "species being" is but Reason in history, the alienated seeker after its own freedom. Rather than God, though, the seeker is man; his alienation consists not in the Creation of immoral, finite reality but in his development of transitory economic forces and exploitative property relations; the end of history, Freedom, is to be a society in which those forces and relations are overthrown. For they are the source of interpersonal estrangement, such as that embodied in the clash of class interests. Obedience to what is, in effect, the general will—pursuit of the common good—depends on the renunciation not of personal appetites but of economic institutions that set some people's self-interest against that of others. This is how, as the young Marx put it, communism is "the genuine solution of the antagonism between . . . man and man . . . between individual and species."[48]

Berlin vs. Positive Liberty

The progression from the paradox of negative liberty to its resolution in the line of thinkers leading to Marx should dispel Fukuyama's notion that Marxism is alien to the Western tradition. But the obvious retort is that positive liberty is not *liberal*, because it is not, in fact, true liberty. For it has served, as Isaiah Berlin put it in his magisterial "Two Concepts of Liberty," as "at times, no better than a specious disguise for brutal tyranny."[49] The problem with such an argument is that, unless it has some historical dimension, it amounts simply to condemning positive liberty from the ground of negative liberty, ignoring the logic that has led Western culture in such directions as Marxism. Fukuyama's neo-Hegelian historical interpretation would, using such a line of defense, become an abstract condemnation of positive liberty rooted in the same ideas that have, in fact, spawned positive liberty.

Berlin himself notes that positive and negative liberty are, "on the face of it," rather close to each other.[50] However, the two *developed* doctrines, revolving as they do around conflicting definitions of liberty, are poten-

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tially incommensurable: partisans of both kinds of liberty can simply refuse to sanction what the other side calls freedom. This would make criticizing positive liberty for being unlibertarian, as Berlin wishes to do, impossible. How, then, is he able to make the charge of "brutal tyranny" against positive libertarianism, a charge positive libertarians would point out is valid only under negative-libertarian criteria of tyranny? To meet such an objection, Berlin must have some *positive*-libertarian basis for calling the potential results of positive liberty tyrannical. So he eschews the abstract repudiation of positive liberty in favor of an historical, or at least dialectical, argument.

Berlin maintains that originally, when it was closest to its negative cousin, positive liberty was good, because it favored individual autonomy (thus the qualification that positive liberty is tyrannical only "at times"). But (step one) a brand of methodological collectivism then allowed the true, free self that had been conceptually split off by positive libertarians from the appetitive, empirical self to be "conceived as something other than the individual (as the term is normally understood), as a social 'whole' of which the individual is an element or aspect: a tribe, a race, a church, a state, the great society of the living and the dead and the yet unborn."[51] Next (step two), positive libertarians declared that empirical individuals

> are actually aiming at what in their benighted state they consciously resist, because there exists within them an occult entity – their latent rational will, or their 'true' purpose . . . and that this inner spirit is the only self that deserves to have its wishes taken into account. Once I take this view, I am in a position to ignore the actual wishes of men or societies, to bully, oppress, torture them in the name, and on the behalf, of their 'real' selves, in the secure knowledge that whatever is the true goal of man . . . must be identical with his freedom. . . .[52]

Combined with step one, step two rationalizes the oppression of the individual by the group in the name of the individual's true freedom.

This is the bad kind of positive liberty, a "perversion" of the good kind; it is autonomous positive liberty progressively turned into its paternalistic, authoritarian "opposite."[53] This narrative allows Berlin to use putatively positive-libertarian criteria to call paternalism tyrannical, without falling into the tautology of merely meaning tyrannical in the negative-libertarian sense.

Berlin's idea is that there is no real warrant for calling coercive paternalism – forcing someone to do something for the sake of his or her own true freedom – a species of liberty. He quotes Kant saying that " 'Pater-

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nalism is the greatest despotism imaginable.' This is so because it is to treat men as if they were not free, but human material for me, the benevolent reformer, to mould in accordance with my own, not their, freely adopted purpose." And to do that "is to deny their human essence, to treat them as objects without wills of their own, and therefore to degrade them,"[54] which is "precisely what the Stoic and Kantian morality protests against most bitterly in the name of the reason of the free individual following his own inner light." Thus, Berlin contends, the argument for positive liberty leads "from an ethical doctrine of individual responsibility and individual self-perfection to an authoritarian state obedient to the directives of an *élite* of Platonic guardians."[55] If individual self-perfection is a (good) version of positive liberty, then it can be set against the paternalistic "apotheosis of authority" that is bad positive liberty.[56]

However, it appears that what makes *self*-perfection seem to be a version of positive liberty of any kind is (1) the fact that positive libertarians such as Kant favored it, and (2) the fact that Berlin has defined positive liberty in such a way that it encompasses self-perfection, even though a better definition would classify self-perfection as a combination of positive and negative liberty.

To Berlin, negative liberty is defined by answers to the question "How far does government interfere with me?," positive liberty by answers to the question "Who governs me?"[57] When Kant argues that true freedom involves not only obedience to moral law but *voluntary* obedience to it, he answers the second question, and thus, by Berlin's definition, embraces positive liberty. Thereafter, according to Berlin, this good kind of positive liberty, self-perfection, metamorphoses into its opposite, which claims the right to *interfere* with individual self-perfection by allowing some people or groups to force *others* to be moral, and thus "free."

Why is it, though, that positive liberty should be seen as a matter of who governs? The most distinctive element in Kant (and Rousseau)—the element from which Berlin wishes to withhold the label liberty—is the insistence that freedom is morality, not the insistence that it be self-imposed.[58] Yet the former is an answer to the question of *what* should govern, not *who*. And conversely, does not negative liberty—the preservation of a sphere of individual choice free from the interference of others—concern itself with *who* governs within that sphere? It appears that if positive liberty is, above all, obedience to moral law, Berlin has radically misdefined both positive and negative liberty.

This misdefinition obscures the overlap between positive and negative liberty that occurs when self-determination—"individual self-

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perfection"—is at issue. For in that case, the exercise of *positive* freedom is served by the *negative* boundaries of the protected sphere. Berlin conflates the positive-libertarian choice to be moral with the negative-libertarian conditions of non-interference under which it is made, crediting good, autonomous positive liberty with what are actually the attributes of negative liberty. This confusion is imported into his denunciation of bad, authoritarian positive liberty, which amounts to an attack on its failure to allow people to choose for themselves whether to be moral. In reality, bad positive liberty is the same as good positive liberty without the admixture of negative liberty. The original doctrine of positive liberty contains within it the complete rationale for what is, to negative-libertarian eyes, "forcing" people to be free. The "steps" by which autonomy-enhancing positive liberty degenerates into authoritarian paternalism are spurious: methodological collectivism is only justified *by positive liberty* if, for some reason, the collective in question is adjudged to be more moral than the individuals it "coerces"; but there is nothing in the doctrine per se that confers such a special status on collectives. And Berlin's claim that the higher self is an "occult entity" is a misrepresentation of the very real paradox of negative liberty noticed by positive libertarians, a caricature of the idea of *right reason* which is already fully present in the original positive libertarian position. The steps from good to bad positive liberty do not exist; "authoritarian" positive liberty collapses back into "autonomous" positive liberty, and Berlin's critique becomes a tautological complaint against positive liberty on negative-libertarian grounds.

The Triumph of Equality

The source of this confusion is in the positive libertarian tradition itself. Thus, Kant merged positive and negative liberty into the idea of individual self-perfection seized upon by Berlin. Why did Kant oppose paternalism, which is a logical outcome of the positive liberty he favored? In this, as in so much else, he followed Rousseau. The general will was not to be imposed by an enlightened despot on his or her subjects—even though if it had been, it would still qualify as positive liberty. Instead, it was to be imposed by the people on themselves. We are not thereby entitled to equate popular sovereignty (self-rule) with positive liberty (morality); if we were, then the rule of all (the rule of "empirical" individuals) would be equivalent to the general will (the rule of our "higher" selves), which it is not. One who favored only the negative liberty of self-rule would say that the rule of all is freedom, regardless of its content. A pure positive

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libertarian would say that obedience to the moral law is freedom, regardless of the source of that obedience. But what Rousseau said is that "the impulse of appetite alone is slavery, *and* obedience to the law one has prescribed for oneself is freedom. . . . One is free yet subject to the laws, since they merely record our [general] wills" (emph. added).[59]

Positive and negative liberty are yoked together by Rousseau's *egalitarianism*. An enlightened despot may not impose positive liberty on the recalcitrant, "since no man has any natural authority over his fellow man."[60] The result of this egalitarianism is *individualism*; thus the social contract, "by its nature, requires unanimous consent."[61] Rousseau did not think he had to *exchange* negative for positive liberty; he could add the latter to the former, combining morality with self-determination and, as well, with a securer basis—the rule of law[62]—for the more rudimentary, "Lockean" form of negative liberty, "civil freedom and the proprietorship of everything [one] possesses."[63]

Hence the pattern Kant followed. Just as, in Rousseau, a free society depends on the self-legislation of moral law through the social contract, in Kant's "kingdom of ends (which admittedly is only an Ideal),"[64] one is both ruler and subject simultaneously—i.e., one is a citizen:

> A rational being belongs to the kingdom of ends as a member, when, although he makes its universal laws, he is also himself subject to those laws. He belongs to it as its head, when as the maker of laws he is himself subject to the will of no others.[65]

To respect each member of the kingdom of ends, to reject paternalism in favor of allowing people to impose the law on themselves, is a different matter than identifying those who choose to do so as free of enslavement to appetite. Self-legislation is in fact an instance of negative liberty, as shown by the fact that it may allow someone to eschew positive liberty by not adhering to the categorical imperative.

In Kant's thought, too, the individualism common to both the aim of freedom from irrational impulse *and* from external compulsion springs from egalitarianism, in this case the egalitarianism embodied in a particular assumption about the nature of reason. Each individual is an end in himself because otherwise, he would be "*merely . . . a means* for arbitrary use by this or that will."[66] What makes such a will arbitrary, and thus not only an enemy of positive liberty but also of individual worth—which must be preserved by negative liberty—is that such a will is

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> in every case only relative, for it is solely [its] relation to special characteristics in the subject's power of appetition which gives [it its] value. Hence this value can provide no universal principles, no principles valid and necessary for all rational beings and also for every volition. . . .[67]

By contrast, the content of the categorical imperative, the rational moral law, is derived purely from "the universality of a law as such."[68] Here Kant trades on an ambiguity: while reason must indeed be universal in the sense of its validity for everyone everywhere, it is not necessarily universal in the sense of mandating the same duties on the part of all rational beings, unless one assumes that the only thing relevant to duty is one's possession of the rational faculty—which comes down to assuming equality. "Duty . . . must therefore hold for all rational beings, and only because of this can it also be a law for all human wills."[69] Thus, egalitarian content is smuggled into a putatively formal system, and the universal validity of reason is made to yield the uniformity of obligation characteristic of societies governed by the rule of law, i.e., by equality rather than hierarchy.

It should be clear that the positive libertarian tradition can accommodate negative liberty when it is also committed to egalitarianism. Thus Marx envisioned the positive liberty of a non-exploitative, non-reified economy—in which production by self-consciously sociable individuals coincides with common economic needs—as being imposed by its participants on themselves, through their equal participation, their "association," in the conscious planning of the economy.

Against this view could be contrasted Andrzej Walicki's interpretation of Marxian freedom as having "nothing in common with 'negative liberty'. It was indeed a perfect example of conceiving freedom as 'positive liberty', or (using Berlin's words) 'the freedom which consists in being one's own master.' "[70] I think this disagreement originates in Berlin, not Marx.

First of all, as Walicki points out, positive freedom is "perfectly compatible with the Fichtian ideal of 'the closed state', regulating all spheres of life of individuals."[71] But Marx did not endorse such a state—because, I maintain, like Rousseau and Kant he sought to combine several kinds of negative freedom, including freedom from paternalism, with (positive) freedom from immoral economic arrangements. His egalitarianism was more than normative: under communism, "empirical" individuals *would* each pursue the common good *without compulsion*. Berlin's misleading use of "self-mastery," which incorporates into the definition of positive liberty what is actually the negative freedom to determine one's own course, distracts attention from Marx's multiple libertarianism.

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On the positive side was Marx's desire to end capitalist appropriation of surplus labor value—that is, to moralize the economy by abolishing exploitation. (Marx did not put it in these terms, but his descriptions of capitalism leave no doubt that he strongly opposed it on moral grounds.)[72] Socialism was to free humanity, collectively, of the need to engage in exploitation, and of the illusion that such evil was natural and necessary. Revolution would express our freedom to do right: the self-interest of the revolutionary proletariat is the general interest of free humankind.

On the negative side, communism would do away with the need for a coercive state of any kind, let alone of the Fichtean variety, by establishing egalitarian economic relations (as opposed to egalitarian economic holdings) among the associated individual producers. In other words, positive freedom from exploitation would accompany negative liberty, in the sense of individual self-determination. Moreover, in another victory for negative liberty, collective self-determination by conscious economic planning would free people of subservience to the fluctuations of the world market—violations of individual autonomy on the part of (arguably) avoidable institutional forces. Finally, communism would replace the tyranny of "forced" labor with freedom to labor as an act of quasi-artistic creativity.

Now Walicki's second argument for Marx as pure positive libertarian can be addressed. While it is true that Marx is famous for repudiating "bourgeois freedom," this, too, qualifies as an argument from "self-mastery" and therefore, it would appear, only superficially from positive liberty. And indeed, Marx's grounds for objecting to bourgeois freedom qualify as being negatively libertarian. Berlin's own words in this connection could have been written by Marx, if he had been using Berlin's positive/negative terminology and if he had agreed that a welfare state, rather than a socialist revolution, could correct the deficiencies of bourgeois freedom:

> The evils of unrestricted *laissez-faire*, and of the social and legal systems that permitted and encouraged it, led to brutal violations of 'negative' liberty—of basic human rights (always a 'negative' notion: a wall against oppressors), including that of free expression or association. . . .
>
> [Laissez-faire also failed to provide] the minimum conditions in which alone any degree of significant 'negative' liberty can be exercised by individuals or groups, and without which it is of little or no value to those who may theoretically possess it. For what are rights without the power to implement them? . . . The case for social legislation or planning, for the welfare state or socialism, can be constructed with as much validity from

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considerations of the claims of negative liberty as from those of its positive brother.[73]

Thus, the way is clear for the destruction of "bourgeois freedom" in order to achieve negative liberty.

Walicki argues that Marx opted for what Benjamin Constant called ancient liberty, the freedom to participate in the polis, rather than for modern liberty, or freedom from interference *by* the polis. Walicki calls the "ancient" variety positive liberty, but in Marxism it is not incompatible with negative liberty because, under true democracy, species-individuals, liberated from class conflict, need not be *compelled* to pursue the common good. Moreover, in criticizing the "freedom" of a wage contract between a starving proletarian and a capitalist, in defending "the proposition that freedom in the absence of compulsion (more precisely: extra-economic compulsion) is worthless to someone who has no means to realize his own aims and thus become a 'master of his fate,' " Marx was at one with Berlin in seeking, in effect, to redefine the *negative* boundaries of interference.[74] There is nothing in the negative conception of liberty that makes neo-liberal arguments for property rights the least bit more "negative" or even individualistic than socialist arguments for subsistence rights or welfare rights, or for a revolution to replace such deficient rights with true negative freedom.

The Antinomies of Pure Liberty

So Marxism is part of a tradition that has depended on three elements—positive liberty, negative liberty and equality—that cannot be excluded from the Western tradition in general or, in particular, from the libertarian ideas that reign in both the West *and* the East. These three elements by no means exhaust the content of Marxism; there are other grounds for seeing it, and its precursors, as antithetical to liberalism. But when Fukuyama argues that in liberalism, the Idea of *freedom* has routed its opponents, one cannot accept that Marxism was one of them.

The way negative and positive liberty and egalitarianism were combined by Marx, admittedly, was not accurately reflected in the "scientific socialism" of the Soviet Bloc, and now even that version of Marxism may be passing completely from history; but supposing, unrealistically, that Marxism in any form were never to be heard from again, its constituent elements have, for all the drama of recent events, not been called into

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question, and can be expected to continue asserting themselves—even as they are now, despite the "end" of history.

Observe how negative liberty is promoted not only by natural-rights neo-liberals, but by the far more numerous social democrats, like Berlin, who point out that *if* negative liberty is important, there is no reason to limit it to the liberty of property-owners. Against this argument, the positing of inviolable property rights against physical coercion is unpersuasive, simply because it remains mysterious even to most *negative libertarians* why a concern for freedom from coercion should be hobbled by such a narrow definition of coercion. The proliferation of rights-claims and demands for self-determination characteristic of our age, not to mention the constant indictments of the power of money and the resulting calls for an egalitarianism that would guarantee a more meaningful form of individual freedom—these phenomena are virtually inevitable once we accept the idea that individual freedom is an end in itself. To insist, as many neo-liberals do, that "true" libertarians must defend only the rights of property is to be blind to the logic of their own doctrine.

Similarly, positive liberty is alive and well and will continue to be as long as there is negative liberty, which carries within it both the urge to freedom and the question of the rationale for freedom to do what is wrong. True, the expropriation of surplus value and the "reification" of social forces are no longer considered by many to be the form of capitalist immorality. While Marx thought that there were contingent, systemic reasons that the pursuit of self-interest led to exploitation, reasons that would be abolished by changing the economic system, contemporary positive libertarianism has returned to a more venerable moralism in decrying the pursuit of self-interest altogether. That "greed is good" is taken to be capitalism's rationale is enough to condemn it in most minds, East and West. That capitalism depends on and encourages the pursuit of personal satisfaction without regard for others founds it in brazen immorality. This moral framework, in the presence of the idea that individual liberty is all-important, will inevitably suggest that true freedom would involve liberation from the selfish appetites that lead to materialism and inequality. Egalitarianism has a wholly different, formal aspect that was touched on above and to which I shall return momentarily; here I point out only that it is part of the hegemonic content of Western morality, and that like abhorrence of filthy lucre, it sits rather uncomfortably with the market order. This is true across what is left of the Iron Curtain, as well; the gravest threat to perestroika may be the widespread popular reluctance to part with the ideal of equality—even when it amounts to the equality of poverty—that animates Communist societies. In East Ger-

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many, fury against the old regime was aroused less by the economic failure of "socialism" than by its "betrayal" by officials who told the people that while "their lives might be less opulent than those of the self-indulgent and greedy West Germans," at least "their system was egalitarian, fair and pure"—even as the leaders lived in luxury unimaginable to the average worker.[75]

Egalitarianism is, however, not just one of the particular values that serves as a source of antipathy to capitalism. It also explains why liberty, positive and negative, is considered valuable in the first place. We are too used to opposing liberty and equality, setting individual rights against egalitarian leveling; but the logic of both is the same. We see this as soon as we ask what we so rarely do: *why* liberty? Any plausible answer must be individualistic in referring to the sanctity of every person. But individualism is, in all probability, historically as well as logically inseparable from egalitarianism—not only in the positive libertarian tradition. Logically, individuals have equal rights if they are *equally* worthy of respect. Historically, to quote L.A. Siedentop, "the assumption that society consists of individuals, each with an ontological ground of his or her own, is a translation of the Christian premiss of the equality of souls in the eyes of God. . . . Freedom thus becomes a birthright or 'natural' right, because no one is deemed to have, *ab initio*, the right to command actions or impose opinions by virtue of his or her intrinsic identity. . . . The premiss of moral equality, claims for conscience and insistence on a range of basic human rights are inextricably bound up together. They form a *gestalt* which is distinctive of Western civilization. . . ."[76] This is the source of Tocqueville's great democratic revolution.

Civilization and Its Discontents

In Hegelian terms, Marxism, egalitarian socialism, and the values they embody are themselves aspects of the World Spirit; their dominance of post-Revolutionary thought is a manifestation not of threats to the Idea, but of its emergence to self-consciousness. As is the case in economics, history "ended" long ago. It is less easy to set a precise date, but 1806 has much to be said for it, inasmuch as the main challenge modern individualism has faced was from the hierarchical, anti-egalitarian values of the *ancien régime*.

The Left that Fukuyama casts as the anti-Western Other is actually the embodiment of modern civilization's highest ideals. These ideals are genuinely powerful: their strength is derived not merely from their

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autonomous reproduction by a culture steeped in them, nor from their congeniality with life in "bourgeois" society,[77] but from their appeal to important aspects of the human condition. As the late Polish neo-liberal Miroslaw Dzielski put it, altruism is the greatest invention of humankind, insofar as it extends the love we feel for some of our fellows to them all. It is that extension, as a theory of social organization, which would have to be opposed if Christian egalitarianism, and individualism, were to be denied—i.e., if history were to "resume" in a new direction. How could this be done? It is not just that our very conception of what it is to be idealistic is imbued with altruism; it is also that it is difficult to turn away from such idealism without turning away from the loving nature of one's humanity.

When history "ended" in 1921, it was not leftist values that had been found wanting: that would have required a departure from the evolution of Western thought, a challenge to its ideals, and to their religious sources, that even the Enlightenment did not dare broach. Instead, leftist goals were found to be *unattainable*. There was never a chance even to test the possibility of absolute individual liberty and equality, for before the utopia had gotten off the ground, it was collapsing of its own weight. When Lenin retreated to NEP, he pulled back from where Spirit wants to go. Unlike 1806, when history's ideological end can be said to have been reached, 1921 was the *anti-teleological* end of history: the beginning of the post-historical era in which the ideal is permanently half-fulfilled in the welfare state attached to the consumer society.

It is pertinent that Mises's impossibility thesis held socialism to be impossible only *if* we are to maintain a complex, industrial economy that sustains billions of lives. In drawing away from the revolutionary precipice, Lenin unwittingly confronted the fact that Western civilization has gotten itself to a point where it depends for its continued existence on a system of production and exchange that is fundamentally at odds with its deepest moral precepts. For those precepts demand that we take the leap into pure socialism—regardless of the *consequences*.

None of this has changed appreciably with the collapse of Communism. If history is "over," still, its resting state is a fragile equilibrium between what Hegel and Marx thought could not come asunder: the real and the ideal. What Polanyi wrote of Communism applies to Western civilization as a whole: "The fantastic demands of its ideology must struggle unceasingly against the limitations of reality."[78] We remain poised at the brink of the practical limits of the Idea, and we have not been happy with having to stop short of its achievement.

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Fukuyama's great merit was that he pointed out the emergence to consciousness (as opposed to the institutional embodiment) of egalitarian individualism. His great deficiency was that he mistook Marxism to be a detour from the Idea. When a Czechoslovak revolutionary recently recited the first lines of the Declaration of Independence to his fellow brewery workers, he was not repudiating socialism in favor of classical liberalism; he was expressing the creed of equal rights that is common to both.[79] When Mikhail Gorbachev told the Communist Party Central Committee that by pursuing perestroika, the Soviet Union "by no means depart[s] from our values but on the contrary . . . seek[s] to fill them with a realistic, humanistic, and democratic content,"[80] he was not putting the best face on his abandonment of his ideals; he was reaffirming them. So was a Bulgarian lawyer who told a rally in Sofia that "the voice of the people is the voice of Heaven, it is the only righteous voice,"[81] and the writer Christa Wolf in her plea for a new East Germany, separate from the Federal Republic, a society of "solidarity," "social justice," and "the freedom of the individual"—the "humanistic ideals from which we proceeded long ago."[82]

The oppositions capitalism-socialism, freedom-equality, liberalism-Marxism, although reflecting the immensely important differences in the lives that are possible in the First and Second Worlds, hinder our understanding of the dynamics of the interventionist welfare states we all inhabit and the ideas that legitimize them. They obscure the impulses that push us in a direction that we are learning, from bitter experience, does not accomplish what we want it to. Considering, though, how inchoate the lessons of experience tend to be, and how subject to interpretations that are colored by our moral ideas—by the Idea—there must be other forces that have stopped more of the world from taking the leap. A Soviet advocate of perestroika recently wrote that "in Russia, the attraction to what exists and the resistance to the romantic dream has never been as great as they are among peoples that have gone through the training in realism and sobriety that exists under capitalism."[83] Training in realism and sobriety: habits of mind imparted by participation in vigorous market economies which, combined with class self-interest and relative economic stability, may explain Western resistance to the direction it *should* move. But such restraints make for an unhealthiness in modern culture. Like those who, in Weber's portrayal of medieval Christendom, were too weak to renounce worldly pleasures in favor of monastic asceticism, our "practical" enjoyment of bourgeois life we consider, at bottom, to be evil. The welfare state is, like indulgences for sins, a poor substitute for morality.[84] The resulting tensions cry out for analysis.

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This part of a theory of the welfare state, like the analysis of its economic continuum, is work that can at this point only be imagined. For the moment we shall have to be satisfied with Hegel's depressing words tinged with hope:

> The life of a people brings a fruit to maturity, for its activity aims at actualizing its principle. But the fruit does not fall back into the womb of the people which has produced and matured it. On the contrary, it turns into a bitter drink for this people. The people cannot abandon it, for it has an unquenchable thirst for it. But imbibing the drink is the drinker's destruction, yet, at the same time the rise of a new principle.[85]

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NOTES

1. Daniel Singer, "The Specter of Capitalism," *The Nation*, August 21/28, 1989: 202–5.
2. Robert Heilbroner, "The Triumph of Capitalism," *The New Yorker*, January 23, 1989: 98–109.
3. Francis Fukuyama, "A Reply to My Critics," *The National Interest* no. 18 (Winter 1989/90): 21.
4. Charles Krauthammer, " . . . Is History History?," *Washington Post*, September 15, 1989.
5. Samuel Huntington, "The Errors of Endism," *The National Interest* no. 17 (Fall 1989): 3–11; responses of Pierre Hassner, Gertrude Himmelfarb, and Stephen Sestanovich to Fukuyama, *The National Interest* no. 16 (Summer 1989): 22–4, 24–6, 32–4; and Strobe Talbott, "The Beginning of Nonsense," *Time*, September 11, 1989: 39.
6. Tina Rosenberg, "Thesis Disperuvian," *The New Republic*, October 9, 1989: 15–7.
7. Notably Leon Wieseltier, "Spoilers at the Party," *The National Interest* no. 17 (Fall 1989): 12, 15.
8. David Stove, response to Fukuyama, *The National Interest* no. 17 (Fall 1989): 97.
9. Francis Fukuyama, "The End of History?," *The National Interest* no. 16 (Summer 1989): 4–5.
10. *Ibid.*, 13, 18. Cf. Hegel, *Reason in History* (Introduction to Lectures on the Philosophy of History [1837]), trans. Robert S. Hartman (Indianapolis: Bobbs-Merrill, 1953), 77, where he refers to the many events of the past that did not lead to the development of Spirit as "so many complications, wars, rebellions, ruins—all this has happened without real history."

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11. E.g., Fukuyama, "The End of History," 3: "The century that began full of self-confidence in the ultimate triumph of Western liberal democracy seems at its close to be returning full circle to where it started. . . . The triumph of the West, of the Western *idea*, is evident first of all in the total exhaustion of viable alternatives to Western liberalism."
12. *Ibid.*, 7.
13. Here I am referring to the rejection of the Leninist ideal of a vanguard party, without prejudice to the issue of how close Communist states have come to attaining it. On the latter question, see Joanna Mizgala, "Liberalism in Poland: Reply to Walicki," *Critical Review* 3, no. 2 (Spring 1989): 348–54, and Andrzej Walicki, "Totalitarianism and Liberalism: Rejoinder to Mizgala," *Critical Review* 3, no. 2 (Spring 1989): 355–68.
14. My argument throughout is most heavily indebted to Don Lavoie, "Political and Economic Illusions of Socialism," *Critical Review* 1, no. 1 (Winter 1987): 1–35. The analysis of early Soviet economic history is developed in Peter J. Boettke, "The Soviet Experiment with Pure Communism," *Critical Review* 2, no. 4 (Fall 1988): 149–82. See also Paul Craig Roberts, *Alienation and the Soviet Economy* (Albuquerque: University of New Mexico Press, 1971), and Michael Polanyi, "The Foolishness of History," *Encounter* 9, no. 5 (November 1957): 33–7.
15. Lenin, *Collected Works* vol. 33 (Moscow: Progress Publishers, 1976), 61. Cf. V. Sirotkin, "Lessons of NEP," *Izvestia*, March 9, 1989:

    > It has become a copybook maxim to assert that the policy of "War Communism" was imposed on the Bolsheviks by the Civil War and the foreign intervention. This is completely untrue, if only for the reason that the first decrees on introducing the "socialist ideal" exactly "according to Marx" in Soviet Russia were issued long before the beginning of the Civil War (the decrees of Jan. 26 and Feb. 14, 1918 on the nationalization of the merchant fleet and of all banks), while the last decree on the socialization of all small handicraftsmen and artisans was issued on Nov. 29, 1920, i.e., after the end of the Civil War in European Russia.

16. Lenin., 63–4.
17. Leon Trotsky quoted in Laszlo Szamuely, *First Models of the Socialist Economic Systems* (Budapest: Akademiai Kiado, 1974), 94.
18. See Walicki, "Karl Marx as Philosopher of Freedom," *Critical Review* 2, no. 4 (Fall 1988): 42. On the derivation of Marx's positive views on socialism from his critique of capitalism, see Lavoie, *Rivalry and Central Planning: The Socialist Calculation Debate Reconsidered* (New York: Cambridge University Press, 1985), ch. 2. Criticisms of Lavoie's position are presented in Tom Bottomore, "Is Rivalry Rational?," *Critical Review* 1, no. 1 (Winter 1987): 43–50.

    Commodity production was retained inasmuch as enterprise managers profited from meeting a plan they helped shape (see below). However, this combined profitable production of "reified" commodities with a failure of

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the commodities produced to meet consumer demand efficiently, satisfying neither capitalist nor communist normative criteria.

19. Peter L. Berger, *The Capitalist Revolution: Fifty Propositions about Prosperity, Equality and Liberty* (New York: Basic Books, 1986), 15–6.
20. *Ibid.*, 21.
21. *Ibid.* Despite his recognition of the important differences between real and ideal-typical socialism (e.g., 81: "There are no 'pure' cases of capitalism and socialism in existence; to that extent, *all* empirically available economies are 'mixed' "; cf. 176), Berger insists on treating the Soviet Union as the ideal type of "modern socialism" (174), which amounts to ignoring, for purposes of analysis, the differences between modern and pure socialism. In the model of socialism this allows him to use, "market forces have (at least officially) been banned" (175); but why should an attempt at realistic analysis turn on official pretensions rather than empirical reality?
22. Lavoie, "Political and Economic Illusions of Socialism," 12–13. Cf. Eugene Zalesky, *Stalinist Planning for Economic Growth, 1933–1952* (Chapel Hill: University of North Carolina Press, 1980), 484: "The existence of . . . a central national plan coherent and perfect, to be subdivided and implemented at all levels, is only a myth. What actually exists, as in any centrally administered economy, is an endless number of plans, constantly evolving, that are coordinated ex post after they have been put in operation."
23. Polanyi, 35–6. See also pp. 105–9 of David Ramsay Steele, "The Failure of Bolshevism and Its Aftermath," *Journal of Libertarian Studies* 5, no. 1 (Winter 1981): 99–111. Another respect in which central planners rely on the market is alluded to by Vasily Selyunin, "Sources," *Novy Mir*, May 1988:

    > The problem here lies not in individual mistakes but in the mistaken idea that you can prescribe from above, more or less in detail, the proportions and priorities of economic development and the scale of production of even the most important products. Our planners themselves belie this idea when they carefully study world trends, which are determined by market forces, in order to plan what we should produce. Thus they tacitly admit that there is a better means than ours for the regulation, or rather self-regulation, of the economy.

24. Alec Nove, *The Economics of Feasible Socialism* (Boston: Allen & Unwin, 1983), 81.
25. The antecedents of the economic critique of socialism developed by Gossen (in 1854), Wieser (1889), Böhm-Bawerk (1889), Pareto (1897), Bagehot (1898), and Pierson (1902) are surveyed on pp. 9–12 of David Ramsay Steele, "Posing the Problem: The Impossibility of Economic Calculation under Socialism," *Journal of Libertarian Studies* 5, no. 1 (Winter 1981): 7–22, as are Weber's, Brutzkus's, and Mises's seminal contributions to the critique (13–21). See Max Weber, *The Theory of Social and Economic Organization*, ed. & trans. Talcott Parsons (New York: The Free Press, 1964), 202–18; Boris Brutzkus, *Economic Planning in Soviet Russia* (London: George Routledge & Sons, 1935), part 1;

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and Ludwig von Mises, "Die Wirtschaftsrechnung im sozialistischen Gemeinwesen," *Archiv für Sozialwissenschaft* 47, no. 1 (April 1920), which appears as "Economic Calculation in the Socialist Commonwealth" in F.A. Hayek, ed., *Collectivist Economic Planning* (London: George Routledge & Sons, 1935). In 1922 Mises expanded his argument in his *Die Gemeinwirtschaft: Untersuchungen über den Sozialismus* (Jena: Gustav Fischer, 1922), trans. J. Kahane as *Socialism: An Economic and Sociological Analysis* in 1936 (London: Jonathan Cape), rev. ed. published 1951 (New Haven: Yale University Press) and 1981 (Indianapolis: Liberty Press).

26. Mises, "Economic Calculation in the Socialist Commonwealth," 103, 108, 98. Although Mises's argument is often said to be that prices provide "information" or "knowledge" about supply and demand to market participants, it is more accurate to say that prices provide *substitutes for* such information. Market participants need not concern themselves with the informational meaning of price changes, except insofar as they are seeking to predict future trends. For the present, it is sufficient that when the price of gasoline goes up, *regardless* of the "meaning" of the price change—i.e., the reason for it—gasoline users will try to use less, and suppliers will seek to provide more. Such motivated behavior is the territory where the lay view of the advantage of markets—"they provide incentives for people to work"—intersects with the Austrian school's epistemological view. By providing profit opportunities that induce people to work, and act in other ways, for the common good, market prices transform what is "information" to an economist—or a central planner—into an incentive for a self-interested economic agent. By contrast, the central planner/bureaucratic interventionist must search for the actual information for which market prices would substitute, if allowed to operate unhindered. This places the interventionist at an epistemic disadvantage. Thereafter, he or she must try to use the "information" in the service of the common good, regardless of self-interest. This places society at a disadvantage, since it depends on the presence of an untainted public spirit in the bureaucracy that, contrary to Hegel, is at best difficult to achieve.
27. Polanyi, 36.
28. For an argument that Marx was not unambiguously a centralist, see David L. Prychitko, "Marxism and Decentralized Socialism," *Critical Review* 2, no. 4 (Fall 1988): 130–2. For an opposing view, see Walicki, "Karl Marx as a Philosopher of Freedom," *ibid.*, 32–46.
29. The question is asked, and answered negatively, in Prychitko, 132–48.
30. Lavoie's *Rivalry and Central Planning: The Socialist Calculation Debate Reconsidered* (New York: Cambridge University Press, 1985), chs. 4–6, shows that contrary to the orthodox interpretation, the "market socialists," led by Oskar Lange—who claimed to have rebutted Mises's "theoretical" argument against socialism and to have forced Hayek and Lionel Robbins to retreat to an argument from "practicability"—never understood that Mises's original

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argument concerned the *theoretical reasons* for the *practical impossibility* of socialist calculation. Consequently, the market socialist "solution," which relies upon impractical theoretical assumptions, has always been entirely beside the point.

One of those who popularized the notion that Lange "demolished" Mises's argument was Robert Heilbroner, in *Between Capitalism and Socialism* (New York: Random House, 1970), 88–93—the same economist who now celebrates "The Triumph of Capitalism." The young Heilbroner claimed that Lange, "the brilliant Polish economist then at Harvard," showed not only that socialist calculation was possible, but that the "superior performance" of the socialist economy would "soon reveal the outmoded inadequacy of a free enterprise economy."

31. Fukuyama, "The End of History," 3.
32. Heilbroner, "The Triumph of Capitalism."
33. Ferenc Fehér and Agnes Heller, "Does Socialism Have a Future? Thoughts about Crisis and Regeneration," *Dissent* 36, no. 3 (Summer 1989): 371–5.
34. Singer, "The Specter of Capitalism." The qualification is that the welfare state must intervene more and grow larger.
35. However, Steele, in "The Failure of Bolshevism," argues that attempts to implement socialism were tried, and failed, on two subsequent occasions, including one under Stalin: in the Soviet Union in 1929–30, and in Cuba in the 1960s (102–4).
36. E.g., Fukuyama, "The End of History?," 13: "If the bulk of the present economic reform proposals were put into effect, it is hard to know how the Soviet economy would be more socialist than those of other countries with large public sectors."
37. Fukuyama, "A Reply to My Critics," 22.
38. John Gray, "On Negative and Positive Liberty," in Zbigniew Pelczynski and John Gray, eds., *Conceptions of Liberty in Political Philosophy* (New York: St. Martin's, 1984), 337.
39. Negative liberty might also be justified if there is no such thing as morality, or if we don't know what it is, and thus should not enforce it; but that "should" reveals a contradiction. Or it might be justified if the harmful consequences of enforcing morality—say, the stifling of intellectual progress, the politicization of society or the disruption of the economy—outweigh the benefits. But this would mean merely that negative liberty is conducive to some other end, such as prosperity or human happiness, not that it is good in itself; and this consequentialist view, so very different from the idea that there is something inherently wrong with violating individual freedom, would need a theory of the welfare state of the sort I called for above in order to reach libertarian conclusions, whereas deontological negative libertarians can be satisfied with rejecting all interventions in the market out of hand.
40. Rousseau, "The Creed of a Savoyard Priest," *The Essential Rousseau*, trans. Lowell Bair (New York: New American Library, 1974), 263.

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41. *Ibid.*, 251.
42. *Ibid.*, 249.
43. Ernst Cassirer, *The Question of Jean-Jacques Rousseau* (Bloomington: Indiana University Press, 1963), 56.
44. Rousseau, *On the Social Contract*, ed. & trans. Roger D. & Judith R. Masters (New York: St. Martin's Press, 1978), 56 (bk. 1, ch. 8).
45. Kant, *Groundwork of the Metaphysic of Morals*, trans. H.J. Paton (New York: Harper & Row, 1948), 70, 95–6.
46. *Ibid.*, 114.
47. Hegel, 50, 53.
48. Marx, *Selected Writings*, ed. David McLellan (New York: Oxford University Press, 1977), 89.
49. Isaiah Berlin, "Two Concepts of Liberty," in his *Four Essays on Liberty* (New York: Oxford University Press, 1969), 131.
50. *Ibid.*, 131–2.
51. *Ibid.*, 132.
52. *Ibid.*, 133.
53. Berlin, "Introduction," in *ibid.*, xlvii.
54. Berlin, "Two Concepts of Liberty," 137.
55. *Ibid.*, 152.
56. Berlin, "Introduction," xlvii.
57. Berlin, "Two Concepts of Liberty," 130.
58. Cf., 131: ". . . the 'positive' conception of liberty: not freedom from, but freedom to—to lead one prescribed form of life. . . ."

    In fact, all freedom except Constant's "ancient liberty" is "freedom from." What Berlin calls positive liberty is actually freedom from immoral forces; what he calls negative liberty is freedom from other forces.

    "Freedom to" would mean that one is enslaved by physical limitations on the achievement of one's desires. None of the theorists in question holds such a notion of freedom. Only when human beings or their passions or humanly alterable institutions are responsible for constraints do constraints count as limits on freedom. "Freedom to live one prescribed form of life" is a form of freedom not because it is "freedom to" but because it is freedom from irrational human impulses.

    By contrast, when Constant pointed out that an individual is no more free merely because the law imposed on her is made by a government in which she participates than she would be if it were made by an autocracy, he showed that the ancient liberty of participation in the polis is fundamentally different from what Berlin calls *both* positive and negative liberty. Ancient liberty is, truly, a question of "who" governs, not in the sense that a negatively free individual is the person "who" governs himself, but in the sense that an individual may not govern himself or herself at all, i.e., may be subjected to every human force imaginable, yet may be held to be free because he is governed by somebody else "who" has consulted him. Such liberty of

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political participation is far different from the superficially similar moral freedom enjoyed by someone forced, in a negative sense, to do the right thing by a paternalistic government. The procedure by which the laws of such a government are selected is quite irrelevant to whether it imposes moral freedom; only the ethical content of the laws matters. But with ancient liberty the situation is reversed—"who" rules matters, not "what" laws they impose. As mentioned in the text, if these were equivalent, then Rousseau would not distinguish between the general will and the will of all. But if they are not equivalent, then it is misleading to equate the positive liberty of Rousseau and his followers with the question of who—in either the negative *or* the ancient sense—rules. (Cf. Berlin, "Two Concepts of Liberty," 163–4.)

59. Rousseau, *The Social Contract*, 56 (bk. 1, ch. 8), 66 (bk. 2, ch. 6). Democratic self-rule can be an instance of negative liberty under one of two conditions: first, if we speak metaphorically and make a collective out to be an individual; second, if the individuals being ruled give their unanimous and ongoing consent to the rules imposed on them. The second is the sense in which Rousseau in politics, and Marx in economics, favor negatively libertarian self-rule. And when the social institutions and attitudes that foster the clash of selfish interests have been removed, they believe that individuals *will* unanimously pursue the common good, whether in government or in economic planning. Positive and negative liberty will therefore coincide in voluntary self-rule. Cf. Shlomo Avineri, *The Social and Political Thought of Karl Marx* (New York: Cambridge University Press, 1968), 38.
60. Rousseau, *The Social Contract*, 49 (bk. 1, ch. 4).
61. *Ibid.*, 110 (bk. 4, ch. 2).
62. *Ibid.*, 63 (bk 2, ch. 4), 66 (bk. 2, ch. 5):

> The social compact established an equality between the citizens such that they all engage themselves under the same conditions and should all benefit from the same rights. . . . The sovereign knows only the nation as a body and makes no distinctions between any of those who compose it. . . . As long as subjects are subordinated only to such conventions, they do not obey anyone, but solely their own will.
>
> Thus the law can very well enact that there will be privileges, but it cannot confer them on anyone by name.

Is this not the ultimate source of Hayek's peculiar, negative-libertarian doctrine of freedom as conformity to the rule of law, defined as a general law that makes no distinctions among specific individuals?

63. *Ibid.*, 56 (bk. 1, ch. 8).
64. Kant, 101.
65. *Ibid.*
66. *Ibid.*, 95, emph. in original.
67. *Ibid.*
68. *Ibid.*, 88.
69. *Ibid.*, 92–3, emph. in original.

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70. Andrzej Walicki, "The Marxian Conception of Freedom," in Pelczynski and Gray, 226.
71. *Ibid.*, 227.
72. On the reconciliation of Marx's moralism with his critique of ideology and his historical materialism, see Kai Nielsen, "Marx and the Enlightenment Project," *Critical Review* 2, no. 4 (Fall 1988): 59–75.
73. Berlin, "Introduction," xlv–xlvi.
74. Walicki, 231. See n 58 above.
75. Serge Schmermann, "Tide of Luxuries Sweeps German Leaders Away," *New York Times*, December 10, 1989: 15.
76. L.A. Siedentop, "Liberalism: The Christian Connection," *Times Literary Supplement*, March 24–30, 1989: 308. Cf. Tocqueville's introduction to *Democracy in America*, trans. George Lawrence (Garden City, N.Y.: Doubleday, 1969), 9–20.
77. See Berger's masterful chapter on "Capitalism and Personal Liberation." To the extent that commercial society encourages individualistic, and therefore egalitarian ideals, it is caught in a "cultural contradiction."
78. Polanyi, 37.
79. Esther B. Fein, "Unshackled Czech Workers Declare Their Independence," *New York Times*, November 28, 1989: 1.
80. "Excerpts from Speech by Gorbachev on Bloc," *New York Times*, December 12, 1989: 10.
81. Clyde Haberman, "50,000 in Bulgaria Demand Faster Move toward Democracy,"*New York Times*, December 11, 1989.
82. Christa Wolf, "The G.D.R. Forever," *New York Times*, December 8, 1989: 31.
83. A. Tsipko, "The Egocentricity of the Dreamers," *Nauka i zhizn* [*Science and Life*], no. 1 (January 1989): 46–56. Abstracted in *The Current Digest of the Soviet Press* 41, no. 12 (April 19, 1989): 21.
84. Max Weber, *The Protestant Ethic and the Spirit of Capitalism* (New York: Charles Scribner's Sons, 1958), 120–1.
85. Hegel, 95.

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Steven Horwitz

KEYNES'S SPECIAL THEORY

THE THEORY OF FREE BANKING:
MONEY SUPPLY UNDER COMPETITIVE NOTE ISSUE

by George Selgin

Totowa, N.J.: Rowman and Littlefield, and Washington, D.C.:

Cato Institute, 1988. 218pp., $33.50

Keynes's analysis of the possibility of underconsumption in capitalist economies is not a general theory of market economies, but rather is relevant, at best, to economies with central banking systems. Selgin helps demonstrate that by contrast, competition in money production can link saving and investment, thus avoiding Keynes's critique. In addition, Selgin's argument provides a framework to understand central banking's inability to achieve its intended results. Many of the macroeconomic problems in historical capitalism can thus be traced to interference with financial markets, rather than to market failures.

The economist Henry Simons once observed[1] that Keynes's criticisms of "the free market" were actually criticisms of unfree central banking regimes. George Selgin's recent book contributes to that perspective by showing how a completely unregulated banking system could avoid the macroeconomic problems that have plagued economies with central banking systems the world over.

If Selgin is right, Keynes's theory of underconsumption is not a "general theory" of capitalism's failures, but a *special* theory about how economies may fail when hampered by specific financial institutions. Aside from misspecifying the problem, the Keynesian theory also provides unsatisfying solutions. Hence, Selgin offers a modernized version of pre-Keynesian theory and a way of eliminating both the problems

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with which Keynes was concerned and those that the implementation of his theories eventually caused.

Money vs. Say

Keynes's objections to laissez-faire derive from his critique of J. B. Say's Law of Markets (as Keynes understood it). In arguing that Say's Law was invalid, Keynes claimed to have overturned more than a century of thinking about the nature of competitive markets.

To Keynes, Say's Law meant that "supply creates its own demand." But this interpretation makes it appear as if Say believed that anyone who supplies a good to the market can be assured of generating a demand for it. This is clearly false. One need only think of the odds of success for something like asparagus-flavored ice cream. Over- or undersupplies of particular commodities do not violate Say's Law. Instead, the Law claims that the macroeconomic *aggregate* supply of goods in an economy generates income sufficient to purchase those goods.

Rather than Keynes's misleading formulation, a more accurate rendering of Say's Law would be: "Production is the source of demand."[2] One can only demand products if one has previously produced something that others wish to buy. The funds one uses to demand goods have to be revenues from previous sales. Therefore, underconsumption (or a general glut of goods) can never be a problem: some producers will fail to cover costs, and others will more than do so, but on the whole, revenues and costs will be offsetting.

In his central work, *A Treatise on Political Economy,* Say describes his law as saying that "it is production which opens a demand for products."[3] Later, Say argues that commodities "will universally find the most extensive demand in those places, where the most values are produced; because in no other places are the sole means of purchase created, that is, values."[4] Say follows with an extended counterintuitive discussion of why a producer is more likely to find success in the competitive environment of Paris, Amsterdam or London than in the countryside, where he is less likely to be burdened by competition. Say's explanation of this anomaly is that only in the cities are there enough *other* producers with the income to buy one's own wares. In the thinly populated country, one may well be the only seller of an item, but with little production elsewhere in the community, people will not have the means to purchase it.

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Following Adam Smith, Say argues that "the wealth of nations" requires producing, not consuming, more. Say concludes his discussion of his Law with the standard classical policy conclusion:

> The same principle leads to the conclusion, that the encouragement of mere consumption is no benefit to commerce; for the difficulty lies in supplying the means, not in stimulating the desire of consumption; and we have seen that production alone, furnishes those means. Thus it is the aim of good government to stimulate production, and of bad government to encourage consumption.[5]

Say's Law of Markets also had something to say about other aspects of a liberal economic order. After arguing that his Law transcends national boundaries, i.e., that the demand for our exports is a result of the productivity of other countries, Say points out

> that each [person] is interested in the prosperity of his neighbour, and every nation in the prosperity of all others: for it is only those who produce much that can readily give you any thing in exchange for your products . . . [that] riches are not exclusive: that, so far from that which another man, or another people gains, being a loss to you, their gains are favourable to you . . . and that wars, entered into for commerce, will appear so much the more senseless as we become better informed.[6]

A nation becomes wealthier by encouraging production through low taxes and a minimal amount of regulation, and by opening trade with other countries, whose production provides the source of demand for its products. Free enterprise and peaceful international relations make economic sense.

Say's Law describes one element of the spontaneous ordering process of the market.[7] Markets are prime social coordinators of individuals and groups; Say's Law indicates one aspect of this coordinating process. Individuals and groups sell productive services (i.e., labor, capital, knowledge, goods, etc.) in exchange for income. With this income they turn around and purchase the productive services of others, who do the same in turn. One's ability to consume is made possible by exchanging with those who value one's supply of productive services. This is what points to the impossibility of a general glut of goods or an "underconsumption" crisis. Aggregate production must generate income sufficient to buy itself up, since the aggregate is nothing more than the sum of individual exchanges of production for production. While particular goods could be (and often are) in excess supply because

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entrepreneurs guess wrong about the extent of consumer demand for them, this could not happen in all markets simultaneously: the income not spent on the oversupplied goods must be being spent on some other goods elsewhere in the economy.

Nor could direct stimulation of consumption increase wealth, because the power to consume must come from previous production. To the post-Sayite, pre-Keynesian economists, government demand-stimulus programs could only transfer wealth, not create it. The recipient's ability to consume had to derive from the productive activities of those who paid the taxes, or sacrificed via inflation, to finance the transfer.

The problem with the early formulations of Say's Law was that they did not fully consider money's role as a mediator of these exchanges of production. In a complex economy, all we see are exchanges of goods and services for money, rather than the ultimate exchange of production for production. Under barter, by contrast, these exchanges would be obvious: the exchange of productions would occur at the same instant. In a money economy, I exchange my productive services not for production that I immediately consume, but for claims against production I may wish to receive in the future. Money, then, introduces a temporal lag between production and consumption. Does this jeopardize the operation of Say's Law?

The "pre-monetary" understanding of Say's Law argued that an over- or undersupply of some goods had to be offset by the opposite situation for other goods. Goods as a whole could never be over- or undersupplied. However, when we recognize that goods exchange against money, a further possibility is raised. For what if the one good in deficient supply is money? This would imply that *all* non-money goods could be in excess supply. If the public were unable to obtain all of the money it desired, merchants would be unable to sell their products at current prices. The result would be an apparent general glut, or underconsumption. An excess supply of goods could result from an excess demand for money.[8]

As the nineteenth century progressed, economists began to realize more fully that the strict validity of Say's Law was intimately tied up with the appropriateness of the money supply. In fact, numerous cases of actual general gluts and shortages had occurred, apparently refuting Say's Law. If banking systems were under- or oversupplying money, then general gluts and shortages were possible. With a deficient supply, economic agents would have to cut prices in order to sell their goods and achieve their desired real holdings of money ("gluts"). With an excess supply, agents would get rid of their excess money holdings and buy goods, driving up prices ("shortages"). Several schools of economists—the

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Swedes, the Austrians and the American monetarists – attempted to explain how monetary disequilibria could spill over to cause the systematic discoordination of non-monetary goods.[9] Most of these theorists argued that maintaining monetary equilibrium, i.e., keeping money supply equal to money demand at a given price level, could eliminate gluts and shortages by removing the source of monetary disturbances of the Say's Law process. It was not enough to recognize that production was the source of demand; it was also necessary to see that the right amount of money was required to make that process work over time. The validity of Say's Law in a monetary world, then, depends on the banking system's ability to maintain monetary equilibrium.

Keynes vs. Say

Keynes asserted that such an equilibrium was unlikely in a market left to its own devices.[10] He pointed out that the decision to hold production in the form of money is made at the individual level and is very difficult to anticipate. Couldn't this make underconsumption possible if producers expect that more spending will occur than actually does? Suppose that in order to save for future consumption, people spend less on current consumption; what is to ensure that entrepreneurs get the message and produce less now and more later? If they did not, then people might, by saving "too much," be consuming "too little."

But the aforementioned monetary equilibrium theorists, especially Knut Wicksell, had an answer to this problem. The saving decisions of individuals and the borrowing decisions of firms are both based on the prevailing rate of interest. As the interest rate rises, people save more by depositing larger money balances in interest-bearing bank accounts. As the interest rate falls, they save less. Investment, on the other hand, works inversely to the interest rate. As rates rise, less borrowing occurs because it becomes more expensive. As rates fall, entrepreneurs are more likely to borrow because more projects are justified at the now lower cost.

Thus, if savings increased at the expense of present consumption, banks would find themselves able to make more loans at lower rates. The amount of new savings would exactly equal the amount of new loans. The fall in current consumption would be matched by a rise in investment to provide for the future consumption desired by savers. An increase in savings through increased holdings of bank liabilities, then, just shifts consumption forward through time. There would be no glut of unwanted goods, because entrepreneurs would respond to the increase in saving by

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increasing investment appropriately. As long as prices—including wages—are allowed to fall in response to a decline in the demand for current consumption, Say's Law would work over time in a monetary economy.

The monetary equilibrium view postulates an intertemporal version of Say's Law made possible (and necessary) by the interest rate which coordinates savers (future consumers) with investors (future producers). Banks serve as institutional intermediaries between these groups by turning savings into investment. Lower interest rates on bank loans correctly signal to investors the need for more future production by increasing the relative profitability of longer-term investment projects.

But the question was, and still is, whether banking systems can, in fact, function in this ideal fashion. Keynes's response was succinct:

> It may well be that the classical theory represents the way in which we should like our Economy to behave. But to assume that it actually does so is to assume our difficulties away.[11]

Keynes argued instead that the Say's Law story may be true if people choose to save by putting money "in the bank," but not if they hoarded their savings as currency in their pockets. (Keynes doesn't call it hoarding, but that's what he has in mind.) As consumers withdraw more cash from banks, banks wind up with *less* money for investment, rather than more—because, we may note, *in central banking systems, currency held by banks counts as reserves off of which they create credit.* Thus, savings hoarded in the form of currency reduce bank reserves, contracting credit instead of expanding it. Even as consumers abstain from current consumption, producers continue to produce for the present, because they are unable to secure loans that would make future production profitable. The result is apparent underconsumption, as store shelves are glutted with goods that consumers currently do not want to buy. Hence, Keynes held, the interest rate could not be relied upon to provide the right signal to coordinate decisions to save with decisions to invest. (In fact, Keynes simply redefined savings and investment as equivalent accounting terms. While it is true that whatever is invested must have been saved, this is only the case *ex post. Ex ante*, as Wicksell had pointed out, plans may not be coordinated, and savers and investors can thus be forced into an *ex post* situation that neither desired; see the discussion of forced savings below.)

Another problem, Keynes contended, was that the decision to save today did not imply a demand for a *particular* future good. An act of consumption today creates a demand for something specific;

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entrepreneurs can see that and react appropriately. But suppose I choose to save: how do entrepreneurs know what things I will want to buy in the future?

> An act of saving means – so to speak – a decision not to have dinner to-day. But it does *not* necessitate a decision to have dinner or buy a pair of boots a week hence or a year hence or to consume any specified thing at any specified date. . . . It is not a substitution of future consumption-demand for present consumption-demand, – it is a net diminution of such demand.[12]

Keynes concluded that

> [the Classical economists] are fallaciously supposing that there is a nexus which unites decisions to abstain from present consumption with decisions to provide for future consumption; whereas the motives which determine the latter are not linked in any simple way with the motives which determine the former.[13]

This is where the Keynesian argument for government policy comes in. When underconsumption required that the intertemporal market had to be coordinated either by an increase in consumption or by an increase in investment, government spending could accomplish the task. Through public works projects, funds could be put in the hands of workers so that consumption spending would rise. Those who received the new government spending as income would only save a fraction of it and re-spend the rest. The income they spent would go to others who would, in turn, spend most of it again. The end result of this process is that the total increase in income would be a multiple (depending on the portions spent and saved) of the original increase in government spending.[14]

Keynes believed that an increase in the money supply could also help by providing funds for investment in private-sector projects. This increase in the money supply need not affect prices very much, due to the level of idle resources created by the original underconsumption crisis. As entrepreneurs found themselves unable to sell off excess production during the crisis, they would first cut their prices and, when that failed, they would reduce their costs, mostly by shutting down production and idling labor and capital. These idle resources could now be called into activity by expansionary monetary policy. Instead of raising prices on existing products (as they would in the absence of idle resources), firms would restart production and put more goods on the shelves. For Keynes, too *much* monetary demand was not a problem to be concerned with.

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Eventually the economy would pull out of the crisis and the need for expansionary monetary policy would pass. Government would have served its role as savior of capitalism, perhaps even heading off economic crises before they became severe.

Price Level Adjustments under Central Banking

Selgin, by explaining how a system of free banking would better avoid both deflation and inflation than does central banking, revives the pre-Keynesian theoretical framework for understanding macroeconomic phenomena. Though Selgin does not directly address Keynes, *The Theory of Free Banking* helps clarify why Keynesianism has not eliminated business cycles in the process of demonstrating why free banking makes more sense than Keynesian fiscal and monetary stimulation. While numerous important theoretical advances have undermined the applicability of Keynesian economics to economies with central banks, even those positions, such as monetarism, can be challenged using Selgin's analysis.[15]

Selgin's conceptual starting point is monetary equilibrium, which occurs when the amount of money banks are producing precisely equals the public's willingness to hold it at the prevailing price level. The reference to some price level is crucial, because *any* nominal amount of money can satisfy the demand for real purchasing power, given an appropriate change in the price level. In the long run, the money supply will always equal the demand for money. The challenge is to minimize long-run price level adjustments, because these cause the *relative* price distortions associated with both inflation and deflation. Changes in the price level do not affect all prices equally; they distort the exchange ratios between individual goods, changing the profitability of various lines of production and discoordinating the plans of producers. This leads to gluts and shortages of particular goods, including labor.

Monetary equilibrium theory recognizes, as Keynes did, that if the supply of money is deficient, producers will find it difficult to obtain the money they need to exercise their potential demands. A producer may have $5 worth of demanded services to offer, but unless someone else has the actual money to pay her with, she has no way (short of barter) to turn those services into the ability to buy from others. Thus, deflation causes a leakage in the Say's Law process, frustrating the movement from production to demand. Keynes referred to this as insufficient effective demand. People have the skills that would entitle them to earn income and demand goods, but the lack of money prevents them from selling their

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services in order to make this demand *effective* in the market, resulting in falling sales, profits and employment.

On the other hand, an excess supply of money, inflation, will entitle some to demand without having produced anything previously. Those lucky enough to receive excess dollars need not have provided services to the market, yet they are able to purchase goods as if they had.

That phenomenon often goes under the name "forced saving," because the purchasing power acquired by those who receive the excess dollars comes from restricting the purchasing power of those who had previously gained money in exchange for production. When excess dollars flow in, the value of previously held dollars is diluted. That loss in real value is matched by the gain of those who receive the excess supply of money and can spend it before prices begin to rise. Inflation distorts the Say's Law process by redistributing real purchasing power away from producers toward those fortunate enough to acquire the excess dollars.[16] So while *ex post*, savings equals investment, this is only because inflationary redistribution has "forced" some people to "save" more than they desired *ex ante*.

This is where the Austrian school's theory of the business cycle becomes useful.[17] The Austrians argue that inflation causes booms and busts by distorting the interest rate, thereby sending incorrect signals about consumer time preferences. Modern central banks inflate by increasing the reserve holdings of member banks, allowing them to create more investment without having acquired savings from consumers. The gain to the banks, and to those who receive the excess investment funds as loans, is the "forced savings" discussed above. The flood of excess money allows banks to lower their interest rates on loans. Entrepreneurs use the borrowed funds to finance longer-term investment projects, but eventually the flow of new funds from the central bank stops, interest rates rise (or fall less quickly), and consumers exercise their true preferences by trying to buy up current production. Firms that took advantage of the artificially low rates find themselves in trouble: they have invested relatively more for the future than they should have, and suddenly must shift to shorter-run processes of production. The original increase in longer-run investment constitutes the boom phase of the business cycle; the shift back toward the short run, and the layoffs and falling prices and profits that accompany it, constitute the bust. For the Austrians, then, the business cycle is the result of inflationary monetary disequilibrium, which Keynesian measures can easily (in the absence of central bank omniscience) bring about in the course of attempting to prevent the *deflationary* disequilibrium Keynes attributed to the market.[18]

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Money Supply Adjustments under Free Banking

If there were some way to prevent, or rectify, excess and deficient supplies of money that did not necessitate price level changes, then the Say's Law process would proceed smoothly and much misery could be prevented. Selgin offers a radically innovative solution: the total deregulation of the banking industry, and the end of central bank monopolization of currency production.[19] The effect of a free banking system, he contends, would be to eliminate the need for price level adjustments in response to money-supply mistakes. Instead, the competitive forces that discipline other goods and services would tend to prevent such mistakes.

In a society with free banking, banks would not only produce deposit liabilities, as they do now, but would also compete to offer hand-to-hand currency for use by the public. The money supply would be determined only by the competitive activities of the banks. Competitively produced "banknotes" would function much like traveler's checks. They would be redeemable in some kind of non-bank money, to be determined by depositor preferences. This could be gold, though for the U.S., Selgin suggests freezing the stock of Federal Reserve Notes and using them as reserves. Government would not need to impose the reserve money or control its quality; doing so would open the door to the repoliticization of this most tempting of all market-generated goods.

Free banking would tend to maintain monetary equilibrium by exploiting the special relationship between bank liabilities and loanable funds. Selgin, in the tradition of the monetary equilibrium theorists, argues that the demand to hold bank money is a demand to save through the banking system: "The aggregate demand to hold balances of [bank] money is a reflection of the public's willingness to supply loanable funds [savings] through the banks whose liabilities are held" (54). We demand money not when we receive it, but rather when we *hold* it. One's demand for money is the level of money balances one saves, whether in one's checking account, in one's pocket, or under one's mattress. When one holds a bank liability, one refrains from claiming the bank's reserves in order to buy something to consume. This allows the bank to issue further liabilities based on the unclaimed reserves. This is true of both currency and deposit liabilities. "Hoarding" bank-created currency is the same thing as having a checking account that one never uses: under free banking, holding bank liabilities, regardless of the form they take, is an act of saving which always encourages the banks to expand their loans correspondingly.[20]

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As Selgin puts it, "whenever a bank expands its liabilities in the process of making new loans and investments, it is the holders of the liabilities who are the ultimate lenders of credit, and what they lend are the real resources they could acquire if, instead of holding money, they spent it" (55). When firms borrow, they spend the new bank liabilities (which materialize in the firms' larger checking account balances) on goods and services. The liabilities are thus transferred to those who sell things to the borrowing firms. The holders of these liabilities, as they pass from hand to hand, are the real lenders of the resources acquired by the borrowers. By exchanging goods and services for bank-issued claims, they agree to postpone consumption until the future.

The keys to free banking are the process by which banks could adjust their reserve ratios in response to changes in money demand, and the process by which unwanted holdings of money flow back to the issuing bank. This flow process is what prevents monetary disequilibria from manifesting themselves as changes in the price level.[21] Under free banking, changes in real money demand are accomplished through changes in the nominal money stock, rather than through changes in the value of money as reflected in the price level.[22]

Suppose, for example, there were a sudden rise in the demand for money, i.e., "too much saving." As long as such saving took place through bank liabilities, here either bank accounts *or currency,* the right investment signal would be sent. As the public held more bank money (i.e., liabilities), the banks would see that there were fewer demands on their reserves. As a result banks would realize that they could afford to issue more liabilities against the same amount of reserve holdings, because the public wished to hold them.

Banks would have an interest in expanding the supply of their liabilities, since they would derive profits from creating more loans against reserves: the more loans, the better. Yet the profitable income from the interest on those loans would have to be balanced against the liquidity risk of lowering their ratio of reserves to total liabilities. Banks that created only an amount of liabilities that people wished to hold would find their reserves in little danger. Banks that issued too many liabilities would face bankruptcy. Banks that underissued currency would be passing up the likely profits from creating further loans against existing reserves. Selgin provides detailed explanations of how calculations of the correct level of loans could occur. The crux of the matter is that banks would gain information unavailable to central bankers by watching their reserve holdings; when withdrawals of reserves slowed, banks would find it profitable to respond by providing more of the liabilities that the public

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wanted. The source of the relevant information, then, would be the distinction between bank-issued money and reserve money, such as gold. Free banks would be able to exploit the informational content of this distinction with regard to the relative demand for currency, an option unavailable with a central bank monopoly of currency.

Holding distinct reserves would be useful not only for banks but for their depositors, who would want some insurance against the overexpansion of credit by their banks. Inasmuch as the desire for such insurance would vary according to customers' conservatism, different reserve ratios might be offered by different banks. In any case, the distinction between reserves and liabilities would not need to be politically imposed.

The equality of the demand and supply of money would ensure that the *aggregate* level of savings and investment remain equal and that underconsumption could not occur. But how would entrepreneurs know *which* goods to produce for the future? That problem is endemic to any system. The market provides prices as a signal to help entrepreneurs in solving it; it would be up to entrepreneurs, including banks, to anticipate which investments would be sound and which would not. The investment funds banks provide are loans that they want to see paid: thus, they have incentives to ensure that borrowers undertake projects that correspond to expected consumer demand. The market is never perfect and guessing the future is always a tricky business, but that is part and parcel of an uncertain world, and no policy can totally alleviate it—though those that reduce monetary instability will do better than others.

One can come up with a number of objections (most of them practical) to this system, and Selgin effectively deals with many in chapter 10. I shall discuss but two broad criticisms here. First, many argue that free banking would be confusing and that banks could never smoothly coordinate their interbank activities. How could one deposit Chase currency at Citibank? To a large extent, banks have already solved this problem by themselves. We think nothing of depositing a *check* written off someone else's Chase account into our account at Citibank. The U.S. has 13,000 different brands of checking account money now, and the banking system does a reasonable job of coordinating the transactions between them. Most of the mechanisms for this coordination developed prior to the establishment of the Federal Reserve; private clearinghouses functioned as efficient ways for banks to coordinate their activities and as means of support for troubled banks.[23] We already have competition (though significantly restricted) in deposit production; Selgin simply wants to apply the logic of open competition to currency.

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A second objection is historical. The U.S. had partially competitive currencies before the creation of the Fed, and the conventional wisdom is that competition failed, causing the financial panics that beset the U.S. in the nineteenth and early twentieth centuries. There is convincing evidence, however, that the pre-Fed American financial crises were the result of existing regulations on note issue. Laws restricting the kinds of assets banks could own caused the supply of currency to be unresponsive to changes in demand, triggering currency panics.[24] Canada, which did not have these restrictions, was relatively immune to panics, and privately produced Canadian currency was used in the U.S. to help ease panics here. As Selgin argues, one will look in vain for free banking systems that failed on economic grounds: "The historical record does not provide any clear evidence of the failure—except politically—of free banking" (15).

A Critique of Interventionism

Selgin's depiction of free banking offers a new vantage-point for evaluating Keynes's preferred solution to macroeconomic problems: central banking. Just as socialist theorists have consistently neglected the task of communicating economic knowledge to the central planner, Keynes neglected the task of communicating monetary knowledge to the central banker. Gosplan, like the Federal Reserve, requires a vast amount of statistical information of dubious reliability in order to figure out what it should do; participants in free markets—and in free banking systems—by contrast, need only look to the profitability of their own enterprises, ignoring the immensely complicated issue of how the entire economy, in all its detail, is doing.

In free markets, all the knowledge needed by economic agents is reflected in (if not "communicated" by) prices. Central planners must attempt to replicate this information synoptically. Under free banking, all the information needed by bankers is in the demand for their liabilities as reflected in the flow into and out of their reserves. Banks would attempt to balance their income from loans against the cost of attracting savings and the risks involved in both loans and the instant redeemability of currency and demand deposit liabilities. How well banks perform this function is revealed by their profits, which are roughly the interest income from loans minus the interest paid on deposits. The knowledge gained from banking experience provides a framework within which the semiotic function of these prices and profits can be, *in effect,* interpreted. Central bankers face the problem of attempting to replicate this informa-

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tion by monitoring an array of *ex post* macroeconomic indicators that lack the details of time and place available to decentralized competitive bankers.

Free bankers would have at their disposal—in the form of the prices paid for deposits and received for loans, and the various determinants of those prices, including the ratio of reserves to liabilities—"information" about the supply of and demand for money that must be, in effect, reconstructed and articulated by central bankers. For central bankers, watching the supply of money is a relatively easy job; in the U.S., individual banks merely report their holdings of currency and their total deposit liabilities to the Federal Reserve System. The Fed then figures out the public's current holdings of currency and adds this to the bank-reported information to obtain a rough, if quickly outdated, measure of the total money supply.

However, the goal of a central bank is not just to know what the money supply is but what it *ought* to be. This requires knowledge of the demand for money, i.e., the amount of wealth that producers (including laborers) wish to save rather than consume immediately. Rather than having adverse clearings determine optimal money supply decisions in accord with the wants of the public, central bankers must rely on statistical devices for estimating the course of money demand. For the unchallenged power which is a central bank's Keynesian *raison d'être* means that its currency must also serve as bank reserves: if anything other than its currency counted as bank reserves, the central bank would not be omnipotent with regard to the supply of money. This is why central banking requires that a monopoly currency be imposed on modern societies by means of legal tender laws. Such laws prohibit the use of alternatives to the monopoly currency, so that a bank's "reserves" against customer withdrawals can only be supplies of currency deposits denominated in the same medium as customer deposits. The upshot of this is that in central banking systems, reserve holdings are transformed from signals of the demand for money into red herrings.

If the central bank responds to deflation by erring in favor of an oversupply of credit, there is no way the public can send a corrective signal, "selling" the excess money back to the issuer by redeeming it for reserves. Instead people can only spend it or put it in their bank accounts—which is the same thing they would do if they wanted *more* future consumption, not less. If people deposit the excess currency, the bank now adds it to its reserves and uses it to create even more credit. If people spend it, then the new recipients of the currency face the same choice. Eventually the greater spending will produce inflation.

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Monetary exchange and a price system provide a non-linguistic way of utilizing knowledge that would otherwise be inaccessible.[25] Whenever markets are replaced by central planning, conscious deliberation must attempt to fill that gap. Selgin argues that

> in essence, the problem of administering the supply of money is like other problems of resource administration. Consumers and businessmen have definite wants for money balances—for deposits and currency—and a banking system should satisfy these wants without diverting resources from more highly valued uses. Like other consumer demands, the demand for money balances cannot be known in advance by any individual or agency; it requires speculation. (94)

Unless one assumes that knowledge must be objective and available to all who wish access to it, it must be conceded that knowledge about demands and supplies, including those for money, is unavailable to "observers."[26] The efforts of free banks to profit from the spread between the price paid for deposits and that received for loans is a method of *using* such knowledge without "knowing" it, whereas central bankers must instead try to know the demand for money directly, by way of statistical research and modeling. Such attempts to construct substitutes for market prices are bound to be Sisyphean.

But such efforts at central planning are entailed by central banking, even in mixed economies with vibrant markets. The central bank must, in effect, try to guess what the demand for its money *would* be, if people were able to use other money and send the correct market signals. If it were to create too little money, people would be unwilling to part with the money they had and reserves would pile up; if too much, people would claim their reserves and flee to other brands. But since such freedom of choice, and the reserve signals that go with it, would deprive central banks of their power to govern markets that Keynes taught us need governing, it is out of the question.

Milton Friedman and Anna Schwartz's work on American monetary history has convincingly documented a 30 percent fall in the money stock following the stock market crash in 1929.[27] This catastrophic event was not precipitated by an equivalent drop in the demand for money, as evidenced by the resulting bank runs and depression. The Fed simply acted incorrectly. It was precisely this kind of problem that the Fed was supposed to prevent when it was created out of the Progressive dreams of the century's second decade, yet the structural ignorance faced by any central administrative agency renders such mistakes likely.

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Although we have not seen another depression like that of the 1930s, central banking even under Keynesian tutelage has not met Keynesian expectations. More recent errors have tended to be inflationary rather than deflationary; the costs of several decades of even moderate inflation have been astronomical. In addition to the tremendous misallocation of resources that inflation engenders, one need look no farther than many of the current crises in the financial industry to find problems that originated in the inflation of the 1970s. Savings and loans that expected very low rates of inflation during the 1960s created thirty-year mortgages on which they charged only 3 or 4 percent interest. During the double-digit inflation of the 1970s and early 80s, those low earnings were locked in even as savings and loans had to pay 17 or 18 percent to attract funds. These negative returns forced some savings and loans into bankruptcy and led many others to undertake risky loan policies (with the protection of federal deposit insurance) in order to recoup.[28] The result has been a huge number of bank failures and a tremendous drain on future U.S. prosperity.

The use of fiscal policy faces the same knowledge-related difficulties facing monetary policy. If investment is too low, and government spending is the desired solution, how can it be known before the fact *which* investments would have been undertaken had the problem not occurred? The lack of profit indicators prevents governments from accessing market knowledge, making it virtually impossible for them to design public works that put economic resources to their most efficient uses. As well, as countless scandals have shown, the lack of profit indicators makes such efficiency an almost irrelevant consideration where the allocation of government resources is concerned. Corruption aside, the bureaucratic allocation of resources makes it desirable to keep expenditures high in order to please constituents or to bargain for a budget increase. Market bureaucracies, such as those in large corporations, tend to be disciplined by the countervailing pressure of lost profits due to high costs—a knowledge signal that is absent from notoriously wasteful public works programs.

This indicates the second problem central banks face. Central bank policy-makers are human beings just like other social actors. The (broadly) self-interested behavior people display in the market must at least be considered a strong possibility when analyzing the behavior of politicians and bureaucrats. It is on this issue that the school of public choice economics is founded.[29] Keynes assumed that monetary and fiscal policy-makers are likely both to understand economic problems and to react to them by pursuing the public interest. But might not the private interests

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of these political actors be at odds with the public interest (however defined)?

The ability to create money willy-nilly gives governments more power to finance their expenditures. (Thus, for example, greater government involvement in the banking system has historically paralleled periods of war or war-like crises.)[30] Since it is in the private interest of politicians to keep their jobs by getting votes, they may try to provide services for constituents while taxing them as little as possible; indeed, evidence for this hypothesis is abundant. Therefore, we might expect central banks to target influxes of money toward politically favored groups in order to earn votes for the politicians who ultimately monitor the bank.[31] At a very broad level, incumbents can exercise pressure on central banks to inflate near election time in order to create the appearance of economic health, postponing the resultant bust until after the election. Inflation also helps borrowers by reducing the real value of their debts, creating a group of voters likely to reward politicians who deliver inflationary monetary policies. Government control of money depends for its success upon the public spirit of bureaucrats; free banking does not, and this must be counted a comparative advantage.[32]

Under central banking, political motives could stimulate deflation as well as inflation, though it is less likely. Given that deflation helps lenders, banks might decide it was in their interest to keep money supply falling relative to demand in order to see their loans paid back in more valuable dollars. If such bankers could exercise sufficient political leverage over the Fed, then this strategy might succeed. In fact, William Greider's investigation of the Fed in *Secrets of the Temple* suggests that the post-Keynes tendency toward inflation may be partly offset by such deflationary pressures.[33] But this is a rather precarious political balance that has sometimes, as in the 1970s, come undone. Given that governments are usually heavily in debt, and that inflation eases the burden of that debt, it is unlikely that continued deflationary policies would be politically acceptable. In either case, it seems problematic to have crucial questions of monetary policy being decided by whose political star is rising on any given day.

Expecting politicized central banks to maintain monetary equilibrium has proved to be in vain (as is hoping they can be insulated from politics). Giving power over the money supply to a centralized authority may appear to make the system more flexible by centralizing decision making, but the unintended consequence is to subject the system to the incentive structures of the political marketplace. Any recognition of this is absent

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from Keynesian thinking about the desirability of discretionary monetary policy.

Fiscal policy falls victim to similar public choice problems. Deficits get votes, independently of the supposed macroeconomic need for them.[34] Politicians who raise taxes or who consistently turn down spending programs for their constituents will tend to find themselves out of their jobs. Expecting politicians to run a deficit or surplus only as they perceive it to be needed by the economy, and expecting them to hold deficits to the minimal amount necessary for a recovery, turns out to be a bit naive in light of twentieth-century experience. Self-interested politicians have to respond to the demands of their voters, and voters tend to want benefits without having to pay the costs. Deficit spending appears to be the perfect solution, regardless of the need.

Of course, not all politicians are purely self-interested; many do try to act in the (perceived) public interest, at least some of the time. But what is important is how well such politicians fare in political competition. Walter Mondale began his 1984 presidential campaign with a forthright pledge to raise taxes, and he never recovered. A politician who does not seek votes is like an entrepreneur who does not seek profits. One can get away with it for a while, but ultimately it is vote-seeking that wins in politics and profit-seeking that wins in an unhampered market.

If we could try harder to insulate economic policy from politics, or to encourage voters to vote for more public-spirited candidates, it might help alleviate the problems created by the incentive structure of politics. But the latter task, advocated since at least Rousseau, is immensely difficult to carry out. The former is precisely what Selgin advocates by calling for the separation of politics and banking. Without such a separation, it is unrealistic to think that central banks will not either eventually be seized by politicians or act in ways designed to prevent such a seizure, no matter how nominally independent they are.

Keynes did not deal with such problems. He assumed both that governments can obtain the necessary knowledge and that they will use it for the public good:

> I expect to see the State, which is in a position to calculate the marginal efficiency of capital-goods on long views and on the basis of the general social advantage, taking an ever greater responsibility for directly organizing investment.[35]

He was not the first critic of the market to exhibit a blind spot when it came to examining the agency that was to correct market failures: the state.

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Keynes's Special Theory

The only way general underconsumption could occur under free banking is if a significant loss of confidence in the banking system led to an unexpected demand to redeem liabilities in the reserve money. Such runs have been extremely rare in competitive systems; to the extent they have occurred under central banking, almost all can be attributed to instability caused by central bank activities and government regulations, such as those of the 1920s and 30s.[36] The Keynesian scenario, then, is almost exclusively relevant to central banking.

But so, too, is the curse of Keynesian monetary policy, inflation. Under free banking, it could be checked, because unwanted money holdings could be sent back to the issuer. Were a free bank to issue more liabilities than the public wanted to hold, people would get rid of the excess notes by direct redemption at the issuing bank, by depositing them at their own bank or by spending them, after which a recipient could ultimately send them back to the issuing bank. The inrush of unwanted notes would cause a drain on the reserves of the issuing bank, necessitating a reduction in its over-extended liabilities. Banks that did not respond this way would risk going out of business if they wound up with reserves insufficient to meet further demands for redemption.

Keynes's essential complaint is actually against not an oversupply of goods but an undersupply of money. When *ex ante* decisions to save have no relationship to *ex ante* decisions to invest, as he insisted is the case under capitalism, the possibility of chronic deflation (*and* inflation) and the apparent invalidity of Say's Law follows. Such deflation manifests itself as apparent underconsumption, since the public is unable to buy all the goods that producers are offering. However, it is really a monetary problem: banking institutions are not supplying an amount of money sufficient to meet the needs of the public.[37] Keynes's complaints should not have been directed against Say's Law and the market per se, but against central banks (and, before that, governmental limitations on free banking) that prevent the production of the amount of credit necessary to make the Say's Law process run smoothly in a money economy.

Selgin's seminal contribution helps to show that Keynesian concerns are, at best, valid only in the absence of monetary competition. What are generally considered to be failures of capitalism are really failures of regulatory interferences with capitalism, many of which, ironically, have been advocated by Keynes and his followers.

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NOTES

1. Henry Simons, "Rules versus Authority in Monetary Policy," *Journal of Political Economy* 44, no. 1 (February 1936): 4, emph. added.
2. In his underappreciated response to Keynes, the late W. H. Hutt described Say's Law as meaning that "the demand for commodities is the supply of non-competing commodities." This formulation is somewhat more precise than the one in the text, which is, however, sufficient for my purposes. See Hutt's *The Keynesian Episode* (Indianapolis: Liberty Press, 1979).
3. J. B. Say, *A Treatise on Political Economy* (New York: Augustus M. Kelley, 1971), 133.
4. *Ibid.*, 134.
5. *Ibid.*, 139.
6. J. B. Say, *A Catechism of Political Economy* (New York: Augustus M. Kelley, 1967), 105–6.
7. The spontaneous order tradition in economics is best exemplified in the works of F. A. Hayek. In particular see his most recent *The Fatal Conceit: The Errors of Socialism,* ed. W. W. Bartley III (Chicago: University of Chicago Press, 1989).
8. David Glasner argues that Say himself was never explicit about monetarily generated disturbances to his Law because he tacitly assumed that banks would appropriately adjust the supply of money to any changes in demand. As Glasner rightly notes, this assumption is the whole point in question. See Glasner's *Free Banking and Monetary Reform* (Cambridge: Cambridge University Press, 1989), 61–3.
9. See George Selgin, "More Revolutionary than Thou," *Critical Review* 3, nos. 3 & 4 (Summer/Fall 1989).
10. It should be emphasized that Keynes was not the first to see this problem. Marx has a similar analysis of Say's Law and the market economy, though his policy prescriptions and his theoretical framework are so radical that they have never equalled Keynes's influence in the economics profession and in Western economies. And as noted in the text, many pre-Keynesian economists had seen this possibility and were attempting to analyze it. Keynes claimed a great deal of unwarranted originality for his break from orthodoxy.
11. John Maynard Keynes, *The General Theory of Employment, Interest and Money* (New York: Harcourt, Brace, 1936), 26.
12. *Ibid.*, 210.
13. *Ibid.*, 21. See also Keynes, *A Treatise on Money,* vol. 1 (London: Macmillan, 1930), 175: "The performance of the act of saving is in itself no guarantee that the stock of capital goods will be correspondingly increased."
14. It is often overlooked that the Keynesian multiplier does not merely apply to government spending. In any situation of idle resources, a stimulus to the flow of spending will call those resources into activity in the way Keynes describes. However, the question is whether there are alternatives to govern-

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ment spending that can "restart" a stalled economy in a better way. W. H. Hutt, in *The Theory of Idle Resources* (Indianapolis: Liberty Press, 1977), argues that downward price adjustments can have the same effect and trigger a market-induced recovery. As wages fall, more workers are hired and the flow of spending increases. The supply of labor from those workers, via Say's Law, will constitute further spending on other goods and services. Hutt points out that Keynes chose not to take this way out because he believed that workers would not accept downward wage adjustments during an "underconsumption" crisis. Keynes thought it was easier to simply use government spending or inflation to accomplish the same purpose. The arguments below, and in Hutt's book, suggest reasons why Keynes may have been wrong.

15. In particular, Milton Friedman's work during the 1960s (see Robert J. Gordon, ed., *Milton Friedman's Monetary Framework* [Chicago: University of Chicago Press, 1974]) deserves mention in this regard. Monetarists such as Friedman have argued that the demand for money is historically more stable, and the responsiveness of investment to changes in the interest rate is greater, than Keynes assumed. The implication is that Keynesian intervention will not have the desired effects. More recently, the rational expectations school has argued that economic agents very quickly anticipate and neutralize the actions of central banks (see Steven M. Sheffrin, *Rational Expectations* [Cambridge: Cambridge University Press, 1983]). Thus, even given the problems generated by central banking, Keynesian policies face great difficulty in achieving economic stability.
16. Remember too, the many slips betwixt cup and lip. During the process of inflation, the distortion of relative prices resulting from this redistribution hampers their ability to convey accurate knowledge and disrupts economic coordination. The resulting misallocation of resources constitutes a net loss in wealth.
17. The best brief summary of the Austrian theory of the business cycle is ch. 1 of Murray N. Rothbard's *America's Great Depression,* 4th ed. (New York: Richardson and Snyder, 1983). More complete versions can be found in Ludwig von Mises, *Human Action* (Chicago: Henry Regnery, 1966), and F. A. Hayek, *Profits, Interest, and Investment* (Clifton, N.J.: Augustus M. Kelley, 1975).
18. Selgin's analysis also points out a problem with the Austrian theory. Some Austrians have advocated either a fixed money supply or a 100 percent reserve requirement as means to prevent inflation. The danger here is that when the demand for money rose, deflation would occur. The usual Austrian response is to characterize the deflation as "gently falling prices." But if prices don't change smoothly when they all rise, why expect smoothness when they fall? Alternatively, what if the demand for money *fell* against a fixed supply? The price level would have to rise and presumably we would get a business cycle, despite the fixed supply. Defenders of 100 percent reserve banking either have

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to assume a fixed demand for money or a demand for money that moves parallel to the supply of base money; or they must explain why a rising price level due to a fall in the demand for money is different from one due to a rise in the supply. Given the empirical unlikeliness of the first two assumptions, and the lack of an answer to the last point, 100 percent reserve banking is insufficiently flexible to maintain monetary equilibrium.

19. Though Selgin does not deal at any length with other aspects of the banking industry, it appears he would also favor removal of regulations such as those limiting interstate branching and the types of assets in which banks may invest.

20. It may seem strange to think of holding currency as an act of saving. Under current monetary arrangements this is not the case. But where currency is a liability of individual banks, when one holds currency one is granting short-term credit. When one sends this currency back to the issuer, one withdraws the credit. The key to good banking practice with competitive currency is anticipating the ebb and flow of short-term savings, such as currency and checkable deposits. Banks today need to have this skill (to an extent) with respect to checking accounts, but not currency.

    Why would banks bother to pay interest on deposits if currency holdings were equivalent to them? The reason is that such accounts could receive deposits in other banks' currencies, which would transfer control over *reserves,* the base for the potential profits from loans, to the bank receiving the deposit. Banks would encourage this by competing to offer interest (and other benefits) on deposits.

21. Free banking changes the way the Quantity Theory of Money (MV = PY) works in practice. Under central banking, changes in M (money supply) cause changes in P (price level) because V (velocity, or the inverse of the demand for money) is assumed constant and Y (total real income) is given. Under free banking, the exogenous variable is V, and M responds to changes in V without any change on the right side. In particular, there is no change in the price level except in response to changes in Y. If free banking works, then one of economic theory's most important propositions, that changes in M cause changes in P, may be relevant only under certain institutional assumptions, such as central banking. See Glasner, 49–91, for an excellent discussion of this point.

22. Since the real supply of money is the nominal supply divided by the price level, Selgin's proposal is simply to make the adjustment through the numerator rather than the denominator.

23. See Richard Timberlake, "The Central Banking Role of Clearinghouse Associations," *Journal of Money, Credit, and Banking* 16, no. 1 (February 1984).

24. See my "Competitive Currencies, Legal Restrictions, and the Origins of the Fed: Some Evidence from the Panic of 1907," *Southern Economic Journal* 56, no. 3, (January 1990). The structural similarities between the 1907 panic and the several others that had occurred before it suggest that the causes are not

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unique to 1907. For some evidence on the earlier panics see Gary Gorton and Donald J. Mullineaux, "The Joint Production of Confidence: Endogenous Regulation and Nineteenth Century Commercial-Bank Clearinghouses," *Journal of Money, Credit, and Banking* 19, no. 4, (November 1987).

25. See Don Lavoie, "The Market as a Procedure for the Discovery and Conveyance of Inarticulate Knowledge," *Comparative Economic Studies* 28, no. 1 (Spring 1986).
26. On the personal coefficient of knowledge, see Michael Polanyi, *Personal Knowledge* (Chicago: University of Chicago Press, 1958). Personal knowledge, argues Polanyi, is what makes us human. To imagine that knowledge is purely objective is to imagine a world where knowledge exists without knowing humans. Ultimately the world of the economic planner, whether comprehensive (socialist) or Keynesian, must be a world of objective knowledge in which humans lack their humanity.
27. See Milton Friedman and Anna Schwartz, *A Monetary History of the United States, 1867–1960* (Princeton, N.J.: Princeton University Press, 1963).
28. A discussion of these problems can be found in almost any introductory money and banking textbook. A good overview of many of the issues is in Kerry Cooper and Donald R. Fraser, *Banking Deregulation and the New Competition in Financial Services* (Cambridge, Mass.: Ballinger Publishing, 1986), chs. 5 and 6.
29. See James Buchanan, Robert Tollison, and Gordon Tullock, *Toward a Theory of the Rent-Seeking Society* (College Station: Texas A & M Press, 1980), for an overview of public choice insights.
30. It is not coincidental that the dates 1863 and 1914 represent both major American banking reforms and existing or soon-forthcoming wars. Financing a war through the forced savings brought about surreptitiously by inflation is much easier than straightforwardly taxing the citizenry. It is again not coincidental that the persistent inflation of the last twenty years first became significant during the Vietnam War. See the comprehensive historical discussion in Glasner's *Free Banking and Monetary Reform*, ch. 2.
31. See two excellent papers by Richard E. Wagner, "Economic Manipulation for Political Profit: Macroeconomic Consequences and Constitutional Implications," *Kyklos* 30 (1977); and "Boom and Bust: The Political Economy of Economic Disorder," *Journal of Libertarian Studies* 4, no. 1 (Winter 1980).
32. The Federal Reserve System has been a political football since its very inception. The whole debate over its creation was a clash of special interests (see Gabriel Kolko, *The Triumph of Conservatism* [New York: The Free Press, 1963]), and characters such as the first president of the New York Fed, Benjamin Strong, have used the Fed for personal and political gain. William Greider's *Secrets of the Temple* (New York: Simon and Schuster, 1987) documents the influence of politics on recent Fed behavior.
33. This possibility was suggested to me by Jeffrey Friedman.

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34. See the essays in the recent collection edited by James Buchanan, Charles Rowley, and Robert Tollison, *Deficits* (New York: Basic Blackwell, 1986).
35. Keynes, *General Theory*, 164.
36. On the bank runs of the 1930s, see Bert Ely, "The Big Bust: The 1930–33 Collapse—Its Causes, Its Lessons," in Catherine England and Thomas Huertas, eds., *The Financial Services Revolution: Policy Directions for the Future* (Boston: Kluwer Academic Press, 1988), and Selgin, "Legal Restrictions, Financial Weakening, and the Lender of Last Resort," *Cato Journal* 9, no. 1 (Spring 1990).
37. Of course other interferences in the competitive market order can lead to pervasive problems, including apparent underconsumption. Most of these involve interventions in labor markets. Since these problems are not directly monetary and are not addressed within the context of Selgin's book, I have not discussed them here. However, Keynes's support for inflation as a way to bring down wages that are stuck too high clearly relates to the topic. For an elaboration see my discussion of Keynes and Hutt on wages and Say's Law in "Prices, the Price Level, and Macroeconomic Coordination," *Market Process* 6, no. 2 (Fall 1988) and John Egger, "Psychologist of the Ills of Capitalism," *Critical Review* 3, nos. 3 & 4 (Summer/Fall 1989).

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George Selgin

MORE REVOLUTIONARY THAN THOU

THE KEYNESIAN REVOLUTION AND ITS CRITICS: ISSUES OF THEORY AND POLICY FOR THE MONETARY PRODUCTION ECONOMY

by Gordon A. Fletcher

New York: St. Martin's Press, 1987. 348pp., $35.00

A commonplace of the history of economic thought, repeated by Fletcher, holds that Keynes was the first economist of the 1930s to reject Say's Law of Markets. It is argued that Fletcher ignores many of Keynes's contemporaries, especially those influenced by Knut Wicksell, who disagreed with Say but who used a framework for monetary analysis that was sounder in all respects than that of Keynes's General Theory.

Most of those who have written about macroeconomics in the last few decades have a view of the history of that discipline that goes something like this: prior to 1936, economists scarcely paid any attention to what is now termed macroeconomics. The "classics," as these older economists are now styled, were convinced of the inviolability of Say's Law (after the French classical economist Jean Baptiste Say). According to this law, there will always be sufficient (monied) demand to purchase the totality of goods produced for sale in the market, at prices adequate (on average) to cover their costs of production. Or, as Keynes put it in 1936, supply creates its own demand. An implication of this "law" was that there could never be a "general glut" of goods. Depression and unemployment could not, therefore, occur on a widespread basis. This was held to be true by the classics despite the vagaries of monetary exchange: stripped to its essentials, the role of money was merely as an aid in valuation of goods. Having

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once grappled with the admittedly thorny question of how the value of money itself was determined, there was really very little else for "classical" macroeconomics to concern itself with.

The problem with Say's Law, of course, was that it was frequently falsified—and dramatically so in the 1930s. The classics were entirely at a loss to account for this. Apparently a new theoretical approach was needed—a break from the tyranny of Say. In the midst of the great crisis, when it was most desperately awaited, the break came at long last with the publication of John Maynard Keynes's revolutionary *General Theory of Employment, Interest and Money.*

So much for the conventional history of macroeconomics. The truth is rather different. The validity of Say's Law was questioned by prominent writers throughout the nineteenth century—not only iconoclasts like Thomas Malthus, but also writers who were clearly part of the "classical" tradition, including Henry Thornton, David Ricardo, Samuel Bailey, Thomas Joplin, George Poulett Scrope, and John Stuart Mill, to name just a few. These writers and a host of others took for granted that Say's Law would be valid if there were no substantial change in the demand for money—the means of payment—relative to the supply of it: in this case, increased saving could be assumed to give rise to a corresponding increase in investment, altering the *composition* of the monied demand for goods without affecting its total value. But they also recognized that the "law" could be violated if saving took the form of increased "hoarding" of money itself (instead of purchases of other assets), for then the overall volume of spending would be reduced, and a general glut might ensue. The glut would be eliminated only by a compensating expansion of the supply of money, or by a general lowering of prices (which is equivalent to an increase in the real—but not the nominal—supply of money). Likewise an *overabundance* of money relative to the demand for it might also lead to a general (i.e. macroeconomic) crisis not, to be sure, by directly causing a general glut, but by doing so indirectly by fostering "overspeculation."

These classical roots of modern macroeconomics gave flower to a pathbreaking neoclassical study by the Swedish economist Knut Wicksell. Wicksell's 1898 book, *Interest and Prices,* set forth in detail the requirements for and implications of what was later termed "monetary equilibrium." According to Wicksell, macroeconomic disturbances (which he identified with changes in the general price level) would be avoided if banks would adjust their credits to conform with the "natural" rate of interest. This was the rate of interest at which the volume of investment would just correspond to the volume of voluntary saving—

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including saving in the form of attempted additions to money holdings—with neither a shortfall nor an excess of aggregate, monied demand for goods and services relative to their total, money costs of production. Only such a monetary-equilibrium policy would serve to uphold the validity of Say's Law in the face of changes in the public's propensity to hoard or to dishoard money balances.

Wicksell's analysis heralded a new approach to the study of business cycles, which was embraced by writers from numerous schools. Among them were the Austrians, Ludwig von Mises and F. A. Hayek; J. G. Koopmans in Holland; Dennis Robertson in England; and Gunnar Myrdal in Sweden. All endeavored to build on Wicksellian foundations more complete explanations of business cycles—including cycles in output and employment as well as in prices—than had been elaborated by their classical predecessors. This neo-Wicksellian or monetary-equilibrium approach flourished in the late 1920s and early 1930s. It represented a neoclassical revolution in macroeconomic thought fully equal in significance to the neoclassical revolution in microeconomics which had preceded it by some fifty years. Yet its authors did not disdain classical contributions that came before. They gratefully acknowledged their predecessors and were content to see their works interpreted as a continuation and modification of the "classical" tradition.

Keynes the Promoter

So why was the monetary equilibrium school written out of the history of macroeconomic thought? And how did Keynes end up capturing all the limelight, which at the very least ought to have been shared by the more prominent members of that school? Part of the answer becomes apparent once the authors of the conventional history of macroeconomics are identified. For they are none other than Keynes himself and his devoted followers.

Keynes's neglect of the monetary equilibrium writers was not due to lack of awareness of their contributions. He was certainly aware of the work of Robertson and Hayek, both of whom were in England in the years prior to the appearance of the *General Theory.* Indeed, Keynes had been a close colleague of Robertson at Cambridge, assisting him in the writing of his 1926 book, *Banking Policy and the Price Level.* Their collaboration was such that Robertson, in the preface to that work, professed to not knowing just how many of the ideas contained in it actually belonged to Keynes. In 1930 Keynes returned the compliment (as he would still have

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looked upon it at that time) in the preface to his two-volume *Treatise on Money*—a work which itself was very much part of the neo-Wicksellian, monetary equilibrium tradition. But upon completing the *Treatise* Keynes decided to abandon the Wicksellian framework entirely, forswearing explicit attention to the passage of time ("forget about periods" was his post-*Treatise* advice to a student), and dropping all reference to the possible divergence of saving and investment or to "hoarding" which lay at the heart of the neoclassical approach. In the *General Theory* the Wicksellian tradition led a furtive existence in references—all disparaging—scattered throughout various notes and appendices. Elsewhere it was tacitly lumped together with the doctrines of the dreaded "classics," including their blind commitment to Say's Law and the denial of a macroeconomic problem that this commitment implied.

As if to further distance his work from those of his (mainly unacknowledged) rivals Keynes departed from standard terminology throughout the *General Theory,* coining new expressions even when the concepts involved were clearly the same as those invoked in more familiar terms by less unorthodox writers. Beneath the surface of the *General Theory* lay a sort of monetary equilibrium analysis, albeit an extreme version in which it is implied that there can be too little spending but never too much. Indeed, in the hands of some of Keynes's more recent interpreters (and apologists), including Robert Clower and Axel Leijonhufvud, the *General Theory* becomes a specimen of monetary equilibrium analysis pure and simple—with only subtle differences to distinguish it from its forgotten neoclassical rivals. But such comparisons were a thing Keynes himself seemed anxious to avoid. He wished to promulgate the impression that his theory of depression was altogether lacking in close substitutes: it was to be seen as truly revolutionary—a quantum leap from orthodoxy. This was poor scholarship; but it was also a highly effective means of self-promotion.

The greatest intellectual victims of this subterfuge were, of course, the monetary equilibrium theorists themselves, whose alternative views were never seriously addressed by Keynes or the Keynesians. To Robertson especially such treatment was a crushing blow, from which his long friendship with Keynes would never recover.

Settling an Old Account

Now, half a century later, the Keynesian revolution has lost much of its former attractiveness: its most truly original claim—that output and

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employment are always or practically always positively related to the volume of spending—and associated policy prescriptions seem to many like a bad joke in the wake of several decades of inflation coupled with persistent unemployment. A search for alternatives has led to a resurgence of monetarism (a watered-down, American version of monetary equilibrium theory, without its Wicksellian roots). It has also given rise more recently to New Classical economics—a sort of "hyperclassicism" that comes closer than any other twentieth-century doctrine to upholding Say's Law in its most extreme form. Finally, the search has also led to a less popular revival of interest in the long-neglected works of the neo-Wicksellian monetary equilibrium theorists, including especially Hayek and Robertson.

Thus it has come to pass that the Keynesians, having for so long successfully avoided the task, find it necessary to defend their doctrine against alternatives offered long ago by Keynes's own contemporaries. In *The Keynesian Revolution and Its Critics,* Gordon A. Fletcher—a lecturer in economics at the University of Liverpool—rises to the challenge. Although Fletcher devotes a part of his book to countering the anti-Keynesian claims of monetarist and New Classical ("rational expectations") writers, more of it takes on Hayek, and a still larger part—nearly half of the book—is devoted to Robertson. In a way this is quite fitting, because Keynes's own neglect of Robertson was the least forgivable of his sins of omission: it is as if Fletcher wished to redress an old injustice. Yet the result is far from satisfactory. Indeed, while Fletcher's criticisms of the monetarists and rational expectations theorists often hit the mark (e.g., on page 227: "monetarist theorists find it difficult to attribute to inflation the importance they instinctively feel it should deserve as a concern of economic policy"), and his treatment of Hayek is surprisingly broad-minded given Hayek's commitment to laissez-faire (for which Fletcher has little sympathy), his attempt to paint Robertson as a frustrated Keynesian falls flat. There is a good reason for this: even in terms of Fletcher's own criteria of sound monetary theory, Robertson's approach is better than Keynes's.

Fletcher, naturally, does not see things this way, largely because he remains committed to the myth of Keynes the unrivaled revolutionary, whose ideas stood in stark contrast to those of other members of his profession, all (or practically all) of whom were orthodox devotees of Say's Law. Fletcher even declares outright at one point (xix) that both Hayek and Robertson "can be seen as the embodiment of the (neo-) classical ideas and assumptions from which Keynes struggled to escape"—the implication of Fletcher's placing of "neo" in parentheses

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being that there was no substantial difference between the views of these thinkers and those of J. B. Say. It is impossible to believe that Fletcher really subscribes to such a view, for his own analysis in later chapters makes it abundantly clear that neither Robertson nor Hayek accepted Say's Law in its standard form, and that both were at pains to show how monetary disturbances would lead to macroeconomic crises! (In Robertson's case the initial shock could be a change in the real sector. Nevertheless the result was always a form of monetary disequilibrium.) The worst that can legitimately be said of either is that Hayek in his early works concentrated on the dangers of excessive money supply, paying little heed to the possibility of an excess demand for money—a shortcoming which had its exact counterpart in Keynes's treatment, which was just as one-sided in the opposite direction. As for Robertson, he is even immune to charges of one-sidedness.

The real irony, though, is that whereas monetary equilibrium theorists, including Hayek and Robertson, attacked Say's Law head-on by denying the necessary equality of (voluntary) saving and investment, and by showing how changes in "hoarding" (or, if one prefers, in the velocity of money or the "propensity" to hoard) or in the supply of money could disrupt this equality, Keynes did not. In the *General Theory* he defined saving and investment in such a way as to make them refer to the same thing (using an accounting approach that tacitly overlooked the passage of time); he also insisted on the impossibility of hoarding, pointing out that all money in existence is necessarily being "hoarded" (i.e. held) by someone, and ignoring the neoclassical definition of hoarding as a decline in the velocity of money. In addition, Keynes made the rate of interest the "price" of money, thereby trivializing the problem of monetary equilibrium by making it a matter of adjustment of a single exchange rate. Later on Keynes's followers took this mode of attack even further: inspired by Keynes's notion of a "liquidity trap" (in which the demand for money becomes infinitely responsive to a slight drop in interest rates), and despite the fact that Keynes himself viewed the trap as a hypothetical possibility only, they insisted—in a manner reminiscent of the despised "classics"—on the essential unimportance of money and monetary policy altogether. In short, what was truly outstanding in Keynes's approach was not his denial of Say's Law—which was old-hat by 1936—but rather his having done so in such a confusing, misleading, and roundabout (if not self-contradictory) fashion.

Fletcher might have noticed this himself while writing his second chapter, on the special nature of a monetary economy. The chapter is supposed to represent Keynes's way of thinking in the *General Theory*. But

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it does nothing of the kind. The concepts and terms used in it are not at all Keynesian but are more akin to those of traditional monetary equilibrium theory. For example, on page 14 Fletcher writes, "if Say's Law is to apply to a monetary economy, in equilibrium there must be a *zero* excess demand for money." What is the difference between this alleged Keynesian discovery and the chapter subheading in G. P. Scrope's 1833 treatise which declares that a "general glut of goods presupposes a general want of money"? Aside from the expression "excess demand" (which also pre-dates Keynes), not much. And statements even more like Fletcher's abound throughout numerous works by the pre-Keynesian, neo-Wicksellian theorists. Yet one can comb through the pages of the *General Theory* endlessly without finding the thought expressed in equally straightforward language, and Fletcher himself did not find it useful to quote from Keynes in describing to his readers the special features of a monetary economy. It might have been easier for him to quote from Robertson in this connection—but that clearly would have been contrary to his purpose in later chapters of showing how Keynes had a better understanding of the workings of a monetary economy than Robertson did.

In fact it is not until much later, on page 36, that Fletcher finally lets on that some of Keynes's critics (including Robertson) were also "dissatisfied with orthodoxy"—meaning the extreme version of Say's Law. This incredible admission appears just a few, short chapters after Fletcher's description of the very same theorists as the embodiment of orthodoxy. It also places Fletcher in the awkward position of having to modify his original assessment of neoclassical guilt. Rather than being accused of having upheld Say's Law, it now emerges that Keynes's neoclassical critics are guilty of the less extreme but equally contemptible offense of having shown excessive "piety" for the terms and concepts of their classical forebears. In other words, they stand accused of having failed to make their theories *appear* more revolutionary. Keynes's great virtue, in contrast, was his willingness to make his departure from the classics "complete."

Robertson vs. Keynes on Saving and Investment

But was Keynes's theory also *better*? Because Robertson's views come under closest scrutiny in Fletcher's book, and because this is by far the weakest part of the book, we may concentrate on the smaller issue of whether Robertson's framework was really inferior to Keynes's. Like other monetary equilibrium theorists, Robertson denied that voluntary saving and investment would always be equal in a monetary economy.

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Keynes in contrast revived the orthodox (!) insistence on the necessary equality of saving and investment. However, unlike orthodox theorists Keynes insisted that investment ultimately determines saving rather than *vice versa*; moreover he did not see the essential equality of these magnitudes, however achieved, as constituting a vindication of Say's Law.

Fletcher claims that Keynes's approach is better. So we should expect him to stick with it. Yet he is unable to do so, and instead unknowingly falls back upon the Robertsonian approach. Thus on page 19 he says, "In a monetary economy . . . it is possible to initiate investment demand without any prior real accumulation." Then on page 22 he writes, "To maintain the validity of Say's Law it is necessary to ensure that withdrawals from the income-expenditure stream (voluntary saving) would be matched by a corresponding level of injections (investment)" (Fletcher's parentheses). Now if Keynes is "accurate" in saying "that saving is always equal to investment" (21), what sense can we make of these other statements, except that Say's Law must *always* be valid—which surely is *not* Fletcher's view, but is rather the view of those terrible classics whom Keynes wished to overthrow! Unwittingly Fletcher helps to show how Robertson's approach lends itself more readily than Keynes's to revealing the limitations of Say's Law.

There are also good reasons for insisting on the Robertsonian view that it is voluntary saving that ultimately determines the extent of investment rather than the other way around, for this must be the case if the magnitudes in question are looked upon in real (as opposed to merely nominal) terms. It is true that in the short run the banking system can force upon the public a certain volume of real saving (or "lacking," as Robertson called it) equal to the value of newly created money issued as credits to investors. But as the new money makes its way through the economic system its main effect will be to increase prices—especially the prices of factors of production—until investors' overall command over real resources is no greater than it had been before the expansion took place, and no greater than what is consistent with the *voluntary* decisions to abstain from spending taken by the public at large. In purely nominal terms, of course, the flow of investment has permanently increased, and the flow of saving has risen correspondingly: this is the perspective emphasized by Keynes and his followers. But in real terms it is investment that adjusts to saving in the long run: the Robertsonian perspective. For the Keynesian approach to be construed as accounting for changes in real variables, one must also accept the simplistic view "that the level of employment is a functon of the level of effective demand and not of changes in real wages" (xxii–xxiii). This fails to tell us why an increase in

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spending, involving an increase in the money-value of investment, should lead to lasting additions to the stock of real capital instead of exhausting itself in an increase in prices. Worse, it practically ignores the latter possibility, implying that a sufficient increase in spending could eradicate capital scarcity and drive interest rates to zero. That is a pleasant pipe-dream—one which is, incidentally, taken seriously in the *General Theory*. But attempts to reproduce it in fact would rapidly unfold into an inflationary nightmare.

In contrast the Robertsonian vision is much more sober: it acknowledges that there are definite limits to the public's desire to save, and that the task before the monetary (and fiscal) authorities is to give vent to that desire without attempting to go beyond it. If the public attempts to hold more money, more should be issued so as to recognize their saving without allowing deflationary pressures to take hold. If the public wishes to save less and spend more, the money stock should be reduced accordingly, to avoid a bout of inflation. This, after all, is also what Fletcher recommends in his second chapter. How unfortunate, then, that he spends so much effort deprecating Robertson's identical prescriptions, while extolling the virtues of an alternative theory that may with perfect justice be interpreted as an extended panegyric upon the virtues of an excess supply of money.

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John B. Egger

PSYCHOLOGIST OF THE ILLS OF CAPITALISM

The General Theory *defended Keynes's long-held belief that capitalism could not achieve full employment without government help. The effects of wage rigidity were well known; Keynes tried to show that even price flexibility—contrary to Say's Law—could not reduce unemployment. Keynes did so by hobbling his decisionmakers with "psychological laws," like the consumption function, that linked nominal prices together. These produced a rigidity of relative prices that justified government intervention. Keynes's followers seem to have rejected his psychological theories, emphasizing instead nominal rigidities or uncertainty, either of which is consistent with "classical" thinking and Say's Law.*

Economics was born to explain the apparent harmony of unregulated societies, and with a few dissenters like Malthus and Marx it did so admirably for about 150 years. Then the discipline ran into serious problems. Throughout the 1920s, Britain—still the geographic center of economic science—faced prolonged unemployment that tested economists' confidence in the adequacy of the "natural" order. Many maintained it anyway, identifying the severity and persistence of the unemployment as the result of an unfortunate historical coincidence of several snags. They believed they understood each of them, and that market incentives would resolve them efficiently. But among those who had long suspected that the story was deeper and darker was John Maynard Keynes.

Already one of Britain's best-known economists by the mid-1920s, Keynes accepted the logic of "classical" economic reasoning, but some of it no longer seemed adequate. Like all creative thinkers, his intuition ran well ahead of his reasoning,[1] and when he had to base his energetic case for public works on the former, he wasn't very persuasive. Yet as the 1930s brought even greater problems, resistance to Keynes's favored policy of

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fiscal stimulus weakened. He continued to search for the source of his conviction that "natural harmony" was not enough, and by 1932 had identified "effective demand" as the heart of the matter.[2] Richard Kahn's "multiplier" and the development of Keynes's theory of interest provided the rest of the story. It was published in 1936 as *The General Theory of Employment, Interest and Money.*

The important source of unemployment for which other economists could not account was "insufficient aggregate demand." Because no adjustments within the market system itself could reduce this form of unemployment, Keynes called it "involuntary." Here at last was a theoretical rationale for public works—and more: an argument that a market system of free individuals would leave them much poorer than necessary, that there were fundamental flaws in unregulated societies, and that while freedom "works" for many things, it cannot be trusted with large economic matters.

In reaching these conclusions, Keynes thought he had overthrown important doctrines of his predecessors. Had he? His followers agreed that the *General Theory* was a major breakthrough, but was the novelty they perceived the one that Keynes intended? And where, then, might New and Post Keynesians enter the story?

All this makes for a fascinating and dramatic tale, full of puzzles and paradoxes. As a story of scientific discovery, it perhaps suggests a work like Watson's story of DNA, *The Double Helix*. But Leland Yeager once warned, and we should keep it in mind, that there is much less assurance in the social than in the natural sciences that "change" is actually "progress."

On the Meaning of the General Theory

Thousands of articles and books have been written about Keynes. Among them is almost surely everything, including the mistakes, that I shall write here. But—as teachers well know—even a new expression of points made better elsewhere can spark understanding. Influences that may be apparent here are those of the economists of the Austrian school, W. H. Hutt, and the "reconstituted reductionism" (as Coddington calls it)[3] of Robert Clower and Axel Leijonhufvud. But I do not consider it naive to have tried to make the strongest influence that of Keynes.

Keynes claimed much in the *General Theory*, not all of it consistent. It was often said that if Keynes were one of five economists in a room, there would be six opinions. To decide "what he really meant," we must separate

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the essentials from the incidentals. Wild ducks and pyramids are surely among the book's incidentals; do rigid nominal wages and the liquidity trap belong with them? How about uncertainty and long-term expectations? None of us can read Keynes's mind, but I shall seek to meet at least two salient criteria in my interpretation.

First, Keynes considered his theory to be importantly different from those of his predecessors. If we believe him, we should look for significant innovation.[4] This criterion excludes such common truths as the proposition that rigid nominal wages often cause unemployment.[5] Second, Keynes himself often told us which innovations he considered important and which he didn't. This throws into doubt the "liquidity trap," about the practical significance of which Keynes had considerable doubt.[6]

There is, however, a family of concepts that meets both criteria. Keynes introduced one of its members, involuntary unemployment, on page six of *The General Theory* as a type of unemployment of which "the classical postulates do not admit of the possibility. . . ."

The concept explaining this unemployment—and the second member of the family—was insufficient aggregate demand: the idea that the volume of commodities that economic decision-makers (individuals and businesses) want to purchase is smaller than the volume of commodities that would be produced at full employment. Now this kind of thing would certainly result if the commodities' money prices were too high, but that is just another old truth: it happens when people try to build up the real value of their cash balances, and the market solution, a drop in the price level, restores both commodity demand and full employment. If Keynes had meant simply that the quantity of commodities demanded would be "insufficient" if their prices were too high, his point would have been pure orthodoxy, so we presume that that is probably not what he meant.

The third and final member of this family of core concepts is Keynes's rejection of Say's Law. Say's Law, a linchpin of pre-Keynesian economics, implies that an "insufficiency" of demand for commodities (relative to the quantity that could be produced at full employment) can result only from the mispricing of some or many commodities and types of labor.[7] Only if Keynes had a notion of *real* "insufficient aggregate demand," one that changes in prices and nominal wage rates could not cure, could he have truly rejected Say's Law. He did.

These concepts are both innovative and important (regardless of their validity). They allow Keynes to argue that the market system's principal source of inefficiency and unfairness—involuntary unemployment—is caused by the insufficiency of aggregate demand, which invalidates Say's

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Law. The causal chain forms the macroeconomics familiar to undergraduates: marginal propensities and efficiencies of this and that, liquidity preferences, and so forth. The goal of it all is to demonstrate that the free-market price system contains fundamental flaws that prevent the quantity of commodities that workers are capable of producing from being demanded.

Lord Keynes and Say's Law

Say's Law is implicit in most pre-Keynesian theory, but according to Ludwig von Mises (from whom the title of this section was borrowed), it was never intended as an explicit pillar of classical economics.[8] It was more like a backhand swat, intended to rid serious economists of pesky businessmen who complained that depressions were caused by "too many goods."

In an absolute sense, a society would have "too many goods" only when it had reached and exceeded satiety, when no individual had any desire that required a good he did not already possess. Philosophers can figure out how attractive such a world would be: for one thing, it would have no economists. In its simplest sense, Say's Law just means admitting that we live in a world of non-satiety. Economists who don't accept this are oxymorons.

There can't be too many goods, but this statement of Say's Law leaves room for plenty of other problems. For there can be an incorrect composition of goods. If too many of some things are available, and there can't be too many goods in general, there must be too few of others. This seems straightforward enough, and if we add to it the insight that our judgments about how much of anything we want to buy or sell depend on its price, it is equivalent to saying that the prices of some things are too high and of other things are too low. At prices above equilibrium (the only sensible meaning of "too high"), suppliers want to sell more than demanders want to buy, and if a good's price is "too low" (below equilibrium) its demanders want to purchase more of it than its suppliers want to sell. Any problems that this kind of improper mixture of goods might cause could be resolved by changes in prices. In its most sophisticated interpretation, the term "Say's Law" identifies the entire logical process by which pricing in one market affects the markets for different goods.

It is this interpretation of Say's Law that Leijonhufvud (calling it "Say's Principle") identifies as "necessary for the construction of a consistent theory of any disequilibrium (or equilibrium) phenomenon."[9] If some

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legal restriction holds a good's price at $8 when its new equilibrium price would be $7, for example, Say's Law provides the logic required to explain the effects of this rigidity on the markets for other goods. Its validity does not require that prices instantly fly to their equilibrium levels; indeed, it is especially useful when they don't. But I think Say's Law *does* imply that a rearrangement of the money prices of different goods, whether or not it is empirically likely, is logically capable of eliminating unemployment and other "too many, too few" problems.

Keynes probably would have agreed that if it were possible for each money price independently to take any value, some pattern of them could produce full employment. But he proposed "fundamental psychological laws" that eliminated this independence. His predecessors did not, of course, consider money prices to be literally independent of each other, but the behavioral linkages among them were held to involve valuations that are subject to change when that seems desirable. What is striking about Keynes is the rigidity of his "psychological laws." His money prices were flexible in that any one of them could take on any value, but whatever value it assumed rigidly determined certain others. This made many patterns of money prices unattainable, among them the Say's Law solution to unemployment. Whether these constraints are "logical" or "empirical" may determine whether we believe Keynes held Say's Law to be logically invalid or "merely" empirically irrelevant, but either warrants the claim that he "rejected" it.

The tale of these psychological rigidities that prevent a capitalist economy from resolving its own problems takes many turns. One implication of the presumption that individuals respond mechanically to certain changes is that they ignore other influences. The decisionmakers of Keynes's capitalism care intently about a few things, and not at all about others. Keynes devised a set of behavioral relationships that rendered unattainable the set of relative prices that could resolve unemployment. Changes in the variables that people cared about could not produce the necessary relative prices, and changes that could resolve unemployment were among the things that people did not permit to affect their behavior.

Keynes began his story with widespread unemployment, reflecting the times in which he wrote. Given the money wage rate, the problem is that employers are unwilling to hire all labor because they do not believe they can sell their output at a price that covers costs. The aggregate demand for commodities—by individuals for consumption, and businesses for investment—is "insufficient," given the level of money wage rates. This kind of thing happens often, and the "classical" prescription—offered by many economists during the 1920s—was lower wage rates. Keynes

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responded with his best-known "psychological law," the consumption function, to explain why this would not increase individuals' demand for output. To explain why no feasible price change could increase investment either, he developed a more complex story involving other psychological laws, the rate of interest, money, and financial markets. With the market system incapable of increasing the private demand for output, and hence employers' demand for labor, Keynes had his case for public works.

Faced with unemployment resulting from a money wage rate too high relative to the price at which their product can be sold, workers in the widget industry might well be able to resolve the problem with lower wage demands. But what if the wage cut also reduces the demand for widgets? That seems farfetched, but suppose the wage rate were also reduced in all of the industries that employ the people who normally buy widgets. Keynes argued that the analysis of the effects of widespread wage reduction must consider such a situation. The analysis of one industry might prudently ignore the relationship between income and demand, but to extend that analysis to the overall economy is to commit the "fallacy of composition."

A broad reduction of, say, 5 percent in the money wage rate, Keynes argued, would reduce worker incomes by 5 percent. His "consumption function," a rigid link between individuals' current incomes and their consumption spending, explained that their demand for commodities would, therefore, fall by 5 percent too. If investment followed suit (and Keynes believed it would), the private economy's aggregate demand would fall by the same percentage as wage rates. Output prices would complete the procession, leaving the new money wage rate (5 percent lower) and the new level of output prices (5 percent lower) in exactly the same relative position as before the reduction.

Because workers were simply incapable of reducing their *real* wage rates, Keynes repeatedly argued, even perfectly flexible money wage rates and product prices wouldn't solve the problem of widespread unemployment. The reason was the rigid link between wage rates and product prices, unnoticed or ignored (or denied) by the proponents of Say's Law. This link makes the workers' increase in the supply of labor (via a wage cut) actually cause an offsetting reduction in the demand for labor, leaving the amount of employment unaffected. As Peter Clarke has put it, "if prices and wages simply chased each other down a spiral—since 'one man's expenditure is another man's income'—then in theory there was no means of effecting the necessary cut in real wages."[10] Since there is nothing the workers can do about it, Keynes called the unemployment

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"involuntary." Because the market offers no way out, he called the situation an "unemployment equilibrium."[11]

Perhaps (as Say's Law implies) there is a set of money prices consistent with full-employment equilibrium, but the market system is incapable of achieving it. Analogously, one's construction problem might be solved by fitting two pegs into holes seven inches apart, but if the pegs are connected by a six-inch rod that solution is unattainable, and the fact that one is free to carry the two of them anywhere in the universe is of no help.

The flexibility of prices, in fact, is part of the problem. If product prices were "sticky" or rigid, not falling by the same percentage as nominal wage rates, *real* wage rates could fall and employment would rise. But as long as income (determined, for Keynes, by wage rates) and consumption demand are *connected* inflexibly, nothing short of jolting people into an increased eagerness to spend on consumption could increase employment—except business investment.

If the demand for commodities generated by business investment either rises when consumption falls, or at least does not fall by as great a percentage, then changes in money wage rates will *not* produce a proportional effect on total aggregate demand (consumption plus investment) and prices, so they will indeed produce a change in real wages and employment. To complete the theoretical support for his deep-seated belief that even perfect price flexibility could not reduce persistent unemployment, then, Keynes had to explain why investment could not be trusted to behave like this. That meant challenging the "classical" theory of interest.

The Rate of Interest Doesn't Do Its Job

In pre-Keynesian theory, the rate of interest was determined by the time pattern of consumption that individuals preferred: more now and less later, or vice versa? This determined how—not whether—currently available resources would be used. If people were eager for current consumption, they would not save very much, this high "time preference" would be reflected in a high rate of interest, and the only investments that pay would give eager consumers exactly what they want: a quick turnover or "throughput." A citizenry more concerned about its future would save more (a result of its lower time preference), producing a lower rate of interest and channelling more resources into projects yielding their consumer goods farther out in the future. The rate of interest, to most non-Keynesian writers, was a market price that provided both a picture

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of individuals' preference for current versus future consumption, and an incentive for producers to use current resources according to that preference. There was no question of a lack of demand for full-employment output; the rate of interest was concerned solely with how that output was used.

Money and the use of financial instruments (normally just called "bonds") to facilitate this process posed no special problems to "classical" theorists. Bonds were useful intermediaries that permitted different individuals to do the saving and the investing, and if their rates of return deviated from people's time preferences, market incentives would bring the two back into line. As for money, it behaved much like any other economic good. If people wanted to hold more real wealth in the form of money, anticipating future transactions, and if there were no other changes in their preferences (including time preferences), they would cut all of the forms of their spending by a single proportion. This would reduce the price level (and produce the desired increase in the purchasing power of their money balances) with no effect on the rate of interest. Money and the financial system—in the pre-Keynesian story—made an economy vastly more productive, and while any market could occasionally go awry and pass its problems along to other markets (as Say's Law explains), strong forces were likely to snap them quickly back into consistency with people's real preferences.

Keynes had to find a flaw in this scenario. His challenge to the "classical" theory of interest was so crucial to his case that many of his followers identify it as the keystone of his system.[12] Perhaps drawing on his own experiences as a financial speculator, Keynes argued that in modern economies interest rates are so involved with money and financial instruments and the uncertainty that surrounds them, that the classical theory of interest no longer applies. The path from saving to investing has become a winding one, through money and all kinds of complex financial instruments. Much like the party game in which a story that is whispered in one ear is hardly recognizable at the end of the line, the interjection of these financial devices destroys the classical writers' clean, straight link among saving, the rate of interest, and investment.

It was about 1933 when he came up with a convincing argument to support his doubts about the classical theory of interest.[13] If he could explain why the interest mechanism would fail to provide incentive for businesses to demand for investment the part of full-employment output that individuals saved, he could prove that there would inevitably be unemployment that no market forces could resolve. A portion of full-employment output would be demanded for neither consumption nor

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investment, aggregate demand would be "insufficient," and the failure of the market system would be established.

He found his answer in two hypotheses about the rate of interest, two monkey wrenches thrown into the classical works, as if one might not be enough. (Keynes was a great believer in redundancy; the *General Theory* teems with gratuitous potshots at the market system.) His first concept—liquidity preference—saddled the rate of interest with another job, one that might prevent it from performing its classical saving-investment function. Really more fundamental and important was his second concept, the marginal efficiency of capital, which charged the classical theory of investment with overlooking fundamental problems that would chronically keep investment below full-employment saving. If liquidity preferences (by holding the rate of interst high) didn't keep businesses from wanting to invest as much as individuals would want to save at full employment, problems highlighted in the theory of the marginal efficiency of capital would.

Keynes maintained that people hold money partly as speculation.[14] An individual's money balance is a kind of reservoir to be filled or emptied as the purchase of bonds becomes less or more attractive. Bonds will look good—and the reservoir of speculative balances will be low—when one expects their price to rise. That means expecting the rate of interest to fall, an expectation Keynes believed would emerge when interest rates were high. Conversely, at low rates of interest, they are expected to rise and bond prices to fall; bonds are unattractive and the reservoir fills up.

Adding this innovation to the classical "transactions" theory, he concluded that the amount of money people want to hold varies directly with income and inversely with the rate of interest. If we specify a certain money supply and hypothesize full-employment nominal income, a definite fraction of which is how much money people would want for transactions if full employment prevailed, then the rate of interest has to be low enough to make them want to hold the rest of that money supply for speculative purposes. If they are leery about the future and have a strong speculative demand, the rate of interest that would equilibrate the supply of and demand for money might not be very low. And if it happens to be above the rate at which full-employment saving and investment are equated, its liquidity preference role would keep the rate of interest from doing its classical job. Since investment would then fail to close the gap between full-employment output and consumption, the result would be the "insufficient aggregate demand" for which Keynes searched.

Keynes's theory of the marginal efficiency of capital, developed soon afterward, hypothesized truly fundamental problems that provided a

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second line of defense for his position, even if liquidity preference were found to have theoretical problems or—as Keynes himself suspected—to be empirically unimportant.[15]

The "marginal efficiency of capital"[16] is an internal rate of return, a rate of return expected from investment in a particular capital good. If a business is offered funds at a particular interest rate, it will pursue all projects whose internal rates of return exceed that rate. The dollar cost of the investments that pass this test, at each interest rate, is the schedule of the business's marginal efficiency of capital. It relates the business's desired investment (demand for saving) to the rate of interest.

A major determinant of the marginal efficiency of any investment is the rate of future sales that business planners expect. When Keynes found it useful to allege an inherent instability to capitalism, he infused the captains of industry with "animal spirits" (*General Theory*, 161–2) and "uncontrollable and disobedient psychology" (317), unpredictable swings in optimism and pessimism embraced by all simultaneously. But far more important to his story than capitalism's unpredictability—and seemingly inconsistent with it—was Keynes's argument that it was perfectly predictable: predictably bad.

Besot by "dark forces of time and ignorance" (*General Theory*, 155), the unimaginative and cowardly business planners in Keynes's principal theme would seek refuge in the past. They would base their sales expectations rigidly on trends in *present* sales. If the customers of one firm decided to increase their saving by reducing their consumption of its product, its current sales would decline, so the future sales that it expected—and therefore its current investment demand—would fall too. A classical supply-and-demand tale might describe how a greater supply of saving reduces the rate of interest and increases the amount of investment. But this only works for the other firms who enjoy continued current sales, because it presupposes an unchanged marginal efficiency of capital (demand for saving). A widespread increase in saving, Keynes argued, would put all firms in the position of the one above, with the process of expectations making an increase in the supply of saving actually reduce the demand for saving at least as fast. With the supply of saving rising and the demand for it falling, the price that equates them (the rate of interest) plummets, but the equilibrium "quantity" (the amount of investment) is stuck at some level below the amount of full-employment saving.

This scenario relies on the same kind of mechanism that prevented real wages from falling: an increase in supply produces, inevitably, a reduction in demand that leaves real variables (quantities) at best unchanged. Once again, a psychological rigidity (this time in the formation of expectations)

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produces feedback effects that invalidate the extension of the "classical" reasoning simultaneously to many industries.

Thus, consumption and investment vary directly, with an unanticipated increase in either raising the other—and production, employment, and wealth. (This simultaneous expansion of everything has led some writers to label his approach "depression economics," taking for granted the unemployment of all kinds of resources). "Accelerator" theorists held that individuals' willingness to spend a greater fraction of their income on consumption depletes inventories and leads to an increase in investment demand that is even greater, proportionately, than the causative increase in consumption. The "multiplier" theory that Keynes adopted from Richard Kahn argues that if a surge in business confidence increases investment demand, employment rises, generating more consumption spending and a level of income that is higher by a multiple of the initial rise in investment. Public-works spending, he believed, would also have these effects on income and employment, perhaps even paying for itself in higher tax receipts. But an increase in the preference for saving—traditionally regarded as the source of investment and economic growth—actually reduced investment, income, employment, and output.

Keynes wrapped up his discouraging description of capitalism with the "secular stagnation" thesis. Though it is not easy to see how the miserable economy he has described would get wealthier, his penchant for scattershot redundancy led him to warn that if somehow it did, greater wealth would exacerbate—not cure—the problems of unfairness and unemployment. His principal reason was that higher incomes result in proportionately even higher saving. By his own reasoning this would reduce investment demand, and increase "involuntary unemployment," even more rapidly. The wealthier a capitalistic economy becomes, the further below its potential it operates and the greater its unemployment and inequity.

Of necessity, the solutions to Keynes's conundra had to be found in some agent whose judgments were not limited by the same rules that produce the market's inefficiency and unfairness. This *deus ex machina* was the government, which, until the public-choice theorists began looking into it, was considered to be outside and above the market. *The General Theory* offered little direct policy advice,[17] but it was a theoretical manifesto for stimulative fiscal policy—government could make up the market's inevitable gap between aggregate demand and full-employment output—and, in the long run, for a "somewhat comprehensive socialization of investment" (*General Theory*, 378).

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Varieties of Keynesianism

Although Keynes was capable of writing beautifully, *The General Theory* was such a hastily assembled melange of confused and contradictory attacks on the market system that it immediately called forth translators and interpreters. The most influential was John R. Hicks, whose 1937 "Keynes and the Classics" introduced the IS-LM curves familiar to most students of economics. It was a superb exposition of the relationships between income and the rate of interest implied in Keynes's models.

Hicks's IS (investment equals saving) curve neatly illustrated that because Keynes's investment varies inversely with the rate of interest and his saving varies directly with income, a high rate of interest requires a low level of income if investment and saving are to be equal. Similarly, Hicks's LM (he called it LL) curve illustrated that if Keynes's "speculative" demand for money (varying inversely with the rate of interest) and his "transactions" demand (varying directly with income) are to add up to a total demand (liquidity preference, L) that is equal to a given money supply (M), then when the rate of interest falls (raising the amount of speculative demand) the level of income must fall also (reducing the amount of money demanded for transactions). Hicks plotted these relationships on the same graph, with income on one axis and the rate of interest on the other. They looked just like ordinary supply and demand curves, with IS sloping downward and LM upward. Where they intersect (if they do), the rate of interest and level of income equate Keynes's saving and investment, and his demand for and supply of money, simultaneously. Unfortunately, the income at which this all happens can still fall short of full-employment income.

Hicks argued that that this apparatus could just as well illustrate "classical" theory, and that Keynes's principal innovation was simply a peculiarly shaped LM curve. According to this "liquidity trap," the rate of interest that equates the demand for and supply of money might have a definite minimum well above the rate required to equalize full-employment saving and investment. Perhaps businesses would be willing to invest an amount as large as full-employment saving only if the rate of interest were 2 percent, but individuals do not consider lending at anything less than 3 percent to be worth the trouble and risk. They prefer, instead, to use their savings to add to their money balances—and if the central bank tries to stimulate the economy by expanding the supply of money (trying to increase business investment by reducing the rate of interest), it won't work because individuals just sponge that additional

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money up, too. The liquidity is trapped, and so is the interest rate: it won't go below 3 percent.

Amid all of the mental hangups, the stubborn beliefs that Keynes attributed to individuals living under capitalism, Hicks highlighted only one: a peculiarity that Keynes thought might sometimes characterize people's demand for money and preclude the attaining of any pattern of prices (in particular, the rate of interest) consistent with full employment. "The demonstration of this minimum," Hicks wrote, "is thus of central importance."[18]

It was not long before Hicks was charged with ignoring too much and trivializing Keynes's contribution. Importantly absent from Hicks interpretation, for example, were the "dark forces of time and ignorance" which—among other things—prevented any interest rate from being able to make investment attractive enough to equal full-employment saving. Hicks comforted "orthodox" economists by arguing that Keynes presented a "classical" theory with special assumptions about the interest elasticity of the demand for money and/or the rigidity of nominal wage rates. But Keynes's sympathizers could equally well argue that the *classical* position required the special assumption that the "Keynesian" elasticities were absent. Keynes and the classics had the same theory, but one of them—take your pick, if you care—required special assumptions about elasticities while the other's approach was truly "general."

This integration of Keynes with his predecessors has been called the "neoclassical synthesis"; the "hydraulic" (pump it up someplace and predictably magnified effects emerge elsewhere) or "textbook" Keynesianism it produced comprises the body of ideas still taught today as macroeconomics. Consider the assertion in Samuelson and Nordhaus's popular textbook that "a labor market characterized by perfectly flexible wages cannot underproduce or have involuntary unemployment."[19] (It should not be surprising that Samuelson has remarked that Keynes "failed to make any contribution to economic theory.")[20] Despite the textbook's effusive praise of Keynes, to many writers—this one included—such assertions constitute a complete rejection of Keynes's innovations.[21]

The reliance of this group of Keynesians on rigidities of nominal wages and prices has an amusing relationship to Say's Law. The Law is not only valid in the presence of nominal rigidities but, by implying that an appropriate rearrangement of prices can always produce full employment, draws exactly the same conclusion about their effects as that stated by Samuelson and Nordhaus. But a Keynesian would probably rather back into a hot stove than into an acceptance of Say's Law. A satisfactory solution was to contrive parodies of Say's Law that require perfect price

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flexibility, long-run general equilibrium, an excess demand for money permanently fixed at zero, and/or commodity markets that clear regardless of the level of commodity prices.[22] To find important innovation in their thoroughly classical misinterpretation of Keynes, the textbook Keynesians have been forced to misinterpret his classical predecessors too.

Less conservative interpreters of Keynes, unwilling to accept the glossing over of so many of the psychological problems plaguing Keynes's capitalist decisionmakers, have referred to the "textbook" view as "the neoclassical Bastard" and "the bastard Keynesian system."[23] This group, identified by Alan Coddington as "fundamentalists," rejects the synthesis and considers Keynes to have truly revolutionized economics by emphasizing uncertainty, instability, and indeterminateness. The fundamentalists interpret Keynes as offering a deep, piercing criticism of the whole choice-based structure of economics. Narrowly conceived, the most obvious manifestation of uncertainty is its quenching effect on investment; carried farther, it makes one question the very hypothesis of stable relationships on which economics is based and—in the extreme—of any discernible order in a free economy.

Unfortunately, Keynes hardly seems to have been aware of all of this. As fundamentalist Joan Robinson put it, "there were moments when we had some trouble in getting Maynard to see what the point of his revolution really was."[24] No wonder. The eclectic Keynes was interested in policy, not theory. He wanted to keep the "microeconomic" aspects of the classical approach which he believed worked smoothly to determine the *composition* of investment, but to reject the classical "macroeconomic" determination of the *amount* of investment because of uncertainty and perverse interdependencies. His fundamentalist friends, wanting to reject both, knew he couldn't have it both ways. In classical theory individuals choose quantities of production of different goods, and while the results of these choices can be conceived as an aggregate whose composition and size can be *analyzed* separately, there is no market process that can *determine* size and composition independently. The sweeping range of difficulties Keynes attributed to the decisionmakers of capitalism may imply a much more complete rejection of his predecessors' economics than he was, himself, either aware of or willing to accept.

Aspects of these divergent "hydraulic" and "fundamentalist" approaches seem to be integrated in the "New Keynesian" or "Post Keynesian" view. Uncertainty and incomplete knowledge, which fundamentalists have tried to use to discard choice-theoretic market analysis, are now being used within that framework to explain *why* prices are not always at their market-clearing levels. To the extent that New

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Keynesianism holds the rigidity of nominal prices to be essential to the explanation of unemployment, it rejects both the fundamentalists' interpretation and the view of Keynes's contribution—based on psychological rigidities that produce rigid relative prices—that I advance above.

The fundamentalist Keynesians have found a few friends in the Austrian School, a sympathy strongest in the writings of Ludwig Lachmann. The extent to which the incompleteness of knowledge and the subjectivity of expectations require casting aside equilibrium theorizing is still much debated among Austrians.

New, Right, Both or Neither?

One who delves even briefly into criticism of Keynes is bound to encounter the quip that Keynes said much that was new and much that was right, but that the two sets do not intersect.[25] Obviously this judgment depends on what one understands by the state of theory before Keynes, as well as by the nature of his contribution.

Involuntary unemployment, with its supporting conceptual array, was his principal innovation. Although no money price is explicitly fixed, Keynes's capitalism is packed with rigidities, imposed by the unimaginative and concrete-bound psychologies of its decisionmakers. His "psychological laws" prevent the attainment of patterns of money prices that might—according to Say's Law—resolve the problems of unemployed resources. These behavioral relationships provided the rigidities that Keynes needed to explain why capitalism couldn't solve its own problems. He knew there was no novelty in the insight that a fixed money price (say, a nominal wage rigidity) could cause unemployment. So he attempted to demonstrate that individuals were psychologically incapable of permitting important *relative* prices to attain the values that would resolve the malaise.

We cannot examine all of the criticism that these hypothesized rigidities have provoked. Milton Friedman's "permanent income hypothesis," for example, targeted the rigid link between current income and consumption; Hayek criticized Keynes's implication that a drop in consumption reduced the demand for labor proportionately by defending Mill's (1848) proposition that the "demand for commodities is not demand for labour."[26]

A reduction of, say, 5 percent in the money wage rate reduces workers' incomes by 5 percent only if employment remains constant. It is all too easy to generalize from a full-time worker who finds his paycheck 5

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percent smaller. Keynes seems to have envisioned all employers getting together, considering a 5 percent wage cut, realizing that this would reduce the demands for all of their products, and deciding unanimously not to hire more labor at the lower wage rate. Real markets don't work like that. Employment is an exchange between individual employers and workers, and the usual reason for a lower wage is to increase employment. If an employer and his employees agree on a 5 percent wage cut to increase employment, then incomes do not fall by 5 percent (and may actually rise), consumption spending and commodity prices do not fall by 5 percent, and the whole Keynesian scenario is short-circuited. Real and money wage rates move together, and their downward move toward equilibrium increases the quantities produced, and the level of employment, in both this and other industries.

Keynes was critical of his predecessors' "fallacy of composition," the erroneous belief that an action that benefits one individual if taken by him alone would benefit all if all took it. (Standing up at a ball game is a typical illustration.) Most textbooks parrot this point around page 3. But it presupposes that each individual's action makes others worse off. Its relevance to individual acts of saving or of accepting a lower wage rate is, therefore, properly not the starting point of analysis but its conclusion. Keynes used psychological rigidities and aggregate decisionmaking to defend his beliefs that the effects on others of these individual acts are harmful; a classical theory—not hampered by Keynes' behavioral assumptions—is likely to consider them beneficent.

Consider Keynes's tale of too much saving and too little investment. It is supposed to be axiomatic that savers and investors are different people. All the textbooks say so. The amount that investors (businesses) want to invest, given their future sales expectations, depends on the rate of interest. But Keynes argued that savers (individuals) determine their saving based on their *income*, virtually independently of the rate of interest, which they use only to determine the form (bonds or money) in which they hold their saving.

As Robertson once put it, Keynes seemed to have "a curious inhibition against visualizing more than two margins at once."[27] Writers not hobbled by Keynes's theory of interest understood that one allocates one's income according to its best advantage. Suppose that an individual wants to provide for future consumption, but business borrowers have just read Keynes's chapter on the marginal efficiency of capital and become so discouraged that they are unwilling to offer an attractive rate of interest on the bonds they are trying to sell. The individual will then purchase assests (*invest*, say in a freezer, books, or a small farm) himself. If neither

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the explicit interest offered by potential borrowers nor the interest return implicit in self-investment in assests (including money) exceeds the individual's subjective time preference, he will again choose the option with the best rate of return: current consumption. This means that however one defines "saving" and "investment," the artificial separations and bifurcated decisionmaking of Keynes's approach breaks down, the "saving" schedule will intersect the "investment" curve at some rate of interest, and there is no question that the entire full-employment output will be demanded.

The marginal efficiency of capital is a fine concept, but Keynes's effort to use it to explain the inevitability of insufficient aggregate demand is unsuccessful. He is left with the claim that the dependence of the demand for money (liquidity preference) on the rate of interest may keep that rate above the rate needed to equate investment to full-employment saving.

As a theory of interest, liquidity preference has been dealt with pretty harshly in the literature. Hutt writes that "the intelligent tyro in economics jumps quite naturally to this kind of conclusion," Frank Knight calls it "mere man-in-the-street economics," and Arthur Marget warns that Keynes is simply committing a very old error by failing to distinguish "the demand for and supply of money loans from the demand for and supply of 'money'."[28] (Those who borrow money seldom do so simply to maintain larger cash balances. When they spend the borrowed money on some asset, they have exercised a demand for "money loans" and for the asset, but not for "money.") The fact that we borrow and lend money—and actually pay or receive our interest in the form of money—makes the rate of interest, as Robertson wryly put it (quoting Marshall), "in some sense a monetary phenomenon."[29] But to non-Keynesian writers, money functions simply as it does in all monetary exchanges: as a medium of exchange and a unit of account. Money has nothing more to do with the rate of interest than it does with the relative price of apples and oranges.

If an individual is offered a higher explicit rate of interest, he surely can—and likely will—reduce his money balances. But he is also likely to work more, consume less, and reduce his holdings of nonfinancial assets. If he decides that owning his $1,000 woodworking tools is worth $80 a year to him (an 8 percent implicit return), but he could lend $1,000 to a potential borrower at 12 percent, he'll sell the tools and lend the money. An explicit monetary rate of interest is something one must forego to hold not only money—as Keynes emphasized to bolster his case for liquidity preference—but all nonfinancial assets.

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In conceiving of a real relationship between the demand for money and the rate of interest, one must carefully preclude implicit changes in time preference. An individual who reduces his money balances by purchasing a dozen oranges combines a lower demand for money with a greater demand for oranges. When orange groves expand and apple orchards shrink, one would not attribute it to a decline in the demand for money. If one buys a bond, he helps to reduce the rate of interest, but he is mixing a lower preference for liquidity with lower time preference; to which should we attribute the fall in the rate of interest? To conceive of a pure increase in an individual's liquidity preference, mixtures like these must be precluded by imagining that there are no changes in his relative preferences for all non-money goods: apples, oranges, shoe-shining services, one-year bonds, thirty-year bonds, and so forth. We must imagine him trying to augment his current money balances by an equiproportionate reduction in the money value of his planned spending on (and holdings of) each of them. Most money prices would fall, and while some would fall more than others, there would be no systematic, predictable effect on relative prices, so the rate of interest would be unchanged. The relationship between "liquidity preference" and the rate of interest, the remaining pillar of Keynes's system, cannot bear the weight. We are properly returned to the classical world in which the demand for and supply of money determine its purchasing power and the preferred time pattern of consumption determines the rate of interest.

One of the famous criticisms of Keynes's work was its lack of concern with the effects of changes in the level of money prices. Don Patinkin's "Price Flexibility and Full Employment" (1948)[30] pointed out that as prices fall—even if Keynes were right that nominal wage rates and prices fall at the same rate—holders of money became more wealthy. This "real-balance effect" will make them willing to consume a greater fraction of their current income.

Old truths again, and new affirmations of Say's Law. The price of the good (money) for which there is an excess demand goes up, the price of the goods that are in excess supply (leisure and commodities) fall, and the problems of disequilibrium prices and unemployed resources are resolved. The process may be painful, of course, but no pre-Keynesian writer would have denied that. It may take "too long," in somebody's opinion. The unions—or businessmen—might cause political trouble. These objections just take us back to "price rigidities": right, but not new.

Price rigidity has long been understood as a major cause of unemployment. To claim that Keynes was an innovator here, one must assert that his predecessors believed that prices and wages instantly flew to their

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market-clearing levels. The instant clearing of markets is, interestingly, easier to read into modern neoclassical microeconomics, with its mathematical comparison of equilibrium states, than into pre-Keynesian "classical" writers.[31] In either case, it's hardly a fair assessment. To claim that the recognition of psychological and institutional causes of wage and price rigidity was an innovation of Keynes, the "hydraulic Keynesians" must distort the history of economics beyond recognition.

Similarly, time and uncertainty are offered by the "fundamentalists" as the core of Keynes's significance. The idea that time was absent from pre-1936 writings is literally incredible, as works on capital and land dating to the earliest days of economics show. And are we to believe that writers on capital and interest thought that the investment decision was made only when its future proceeds were known with certainty? One can, of course, argue that pre-Keynesian writers did not *adequately* consider time and uncertainty. But then the Keynesian innovation is not the recognition of these characteristics, but a more adequate consideration of them. And even this is not true when adequacy is equated with an almost dogmatic determination to portray capitalism as utterly chaotic and perfectly disastrous.

In pre-Keynesian work, it was the job of the rate of interest to convey information about changes in beliefs about both time and uncertainty, and to provide incentive for individuals to act on those changes. Even if captains of industry became more uncertain about future receipts, for example, a lower rate of interest might induce them to borrow; if savers became more uncertain, a higher rate might induce them to lend. The principle is the same as that of a prospective buyer at a yard sale who has sudden doubts about the usefulness of a gadget and reduces his offer for it. Whether he gets it or walks off without it, the market clears. Uncertainty affects behavior. It changes prices and the quantities that are traded. But it provides an excuse for neither market failure nor the failure of Say's Law.

If time and uncertainty are offered simply as explanations of wage and price rigidities, as the New Keynesian position seems to have it, we have more "right but not new." More accurately, there's plenty "new" to be said about the circumstances under which traders conclude that price adjustment is, or is not yet, warranted. If reading Keynes has stimulated some modern researchers to pursue this investigation, perhaps we have him to thank. But the endeavor is clearly a contribution to the classical paradigm. There's nothing "Keynesian" about it. Those who don't realize this usually have a fairy-tale view that every economist before Keynes wrote only about perfect competition and instant market clearing.[32]

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In general, Keynes simply shortchanged the market process. He was eager to devise a logical structure that would support his heartfelt belief that only government action could resolve the misery of his place and time. He found it by attributing to the individuals whose choices constitute the capitalist process a number of psychological rigidities that would prevent them from ever achieving the set of prices that might, according to Say's Law, eliminate unemployment.

It was a masterful job, as fifty years of sound and fury have demonstrated. But the actors of Keynes's capitalism are caricatures of real people, partially lobotomized to retain only the properties that would support his cause. The accurate evaluation of the economics of capitalism requires real, choosing and acting, individuals. They are more likely to be found in the works of the better "classical" and Austrian economists. It is a tragedy of doctrinal history that these writers are well known for their disapproval of the most influential work of this century's most influential economist.

NOTES

1. "The late 1920s were the most active period of Keynes's political career and his initiatives in policy dragged along a justifying body of theory in their wake—sometimes improvised on the spot." Peter Clarke, *The Keynesian Revolution in the Making, 1924–1936* (Oxford: Clarendon Press, 1988), 73.
2. "It seems overwhelmingly likely, therefore, that it was in the summer of 1932 that Keynes believed himself to have grasped the principle of effective demand." *Ibid.*, 263.
3. Alan Coddington, "Keynesian Economics: The Search for First Principles," *Journal of Economic Literature* 14, no. 4 (December 1976).
4. Coddington (1268), seeming to suggest that this perspective invites inaccurate historiography, comments that "the fundamental presumption that underlies the work of Clower and Leijonhufvud is that Keynes said something important, not only for economic policy, but for economic theory. They are saying, 'Let us read the *General Theory* in a search for theoretical innovation.' " One must, of course, be careful with prejudices, but this one seems altogether healthy and necessary.
5. "Nor does the *General Theory* depend upon any assumption about the rigidity of wages." Clarke, 280.
6. John Maynard Keynes, *The General Theory of Employment, Interest and Money* (New York: Harcourt, Brace & World, 1936), 207, for example. But on p. 233, he says that these "certain circumstances . . . will often occur. . . ."
7. My own understanding of the meaning of Say's Law has been heavily influenced by the works of W.H. Hutt (*Keynesianism: Retrospect and Prospect*

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[Chicago: Regnery, 1963] and *A Rehabilitation of Say's Law* [Athens: Ohio University Press, 1974] in particular) and by Axel Leijonhufvud ("Say's Principle, What it Means and Doesn't Mean" [1972], in his *Information and Coordination* [New York: Oxford University Press, 1981]).

8. See Ludwig von Mises, "Lord Keynes and Say's Law," *The Freeman* (October 30, 1950), reprinted in his *Planning for Freedom* (South Holland, Ill.: Libertarian Press, 1962), 64-71. Mises writes on p. 64: "Say's Law was in the first instance designed as a refutation of doctrines popularly held in the ages preceding the development of economics as a branch of human knowledge. It was not an integral part of the new science of economics as taught by Classical economists."
9. Leijonhufvud, 93.
10. Clarke, 274–5.
11. By "equilibrium" Keynes meant that the market contained no forces for change. Modern economists who reserve the term "equilibrium" for the equality of quantities supplied and demanded sometimes find Keynes's use perplexing, especially if they are convinced that any disequilibrium always provides incentive for movement toward equality.
12. Representative of this judgment is John Foster, *Journal of Economic Literature* 27, no. 3 (September 1989), who says on p. 1169: "The author [Gordon A. Fletcher, *The Keynesian Revolution and its Critics*] is at pains to establish early in the book that the theoretical novelty of the *General Theory* is not, as legions of Keynesians believe, about a 'problem' in the labor market, which can be resolved by getting real wages down, but rather in Keynes's treatment of the interface of money and finance with the real economy."
13. "Having experienced this revelation, Keynes recalled, 'the result of it was to leave the rate of interest in the air. If the rate of interest is not determined by saving and investment in the same way in which price is determined by supply and demand, how is it determined? . . . Then, appreciably later, came the notion of interest as being the measure of liquidity-preference, which became quite clear in my mind the moment I thought of it.' " Clarke, 263.
14. Keynes viewed money as a financial asset held for "precautionary" and "finance" motives as well as the more important "speculative" motive—and the ever-present "transaction" motive—discussed here. These other reasons for holding cash add nothing significant to the theory.
15. "Neither Keynes's rejection of the classical theory, therefore, nor his advocacy of the new theory of effective demand, depended crucially upon liquidity preference being true." Clarke, 264.
16. "More precisely, I define the marginal efficiency of capital as being equal to that rate of discount which would make the present value of the series of annuities given by the returns expected from the capital-asset during its life just equal to its supply price." Keynes, 135.
17. Cf. Clarke, 305: "There is almost nothing in the *General Theory* that speaks directly to the 'Keynesian' policy agenda. . . . The necessity of central controls

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to govern the volume of output as a whole was his theme; but he did not develop it into a policy blueprint in the *General Theory*."

18. John R. Hicks, "Mr. Keynes and the 'Classics'; A Suggested Interpretation," *Econometrica* 5 (1937): 147–59. Reprinted in William Fellner and Bernard F. Haley, eds., *Readings in the Theory of Income Distribution* (Homewood, Ill.: Richard D. Irwin, 1951), 471.
19. Paul A. Samuelson and William D. Nordhaus, *Economics* (New York: McGraw-Hill, 1989), 289.
20. Paul A. Samuelson, "The General Theory," *Econometrica*, July 1946; as cited by D. E. Moggridge, *John Maynard Keynes* (Middlesex: Penguin Books, 1976), 161.
21. "It is simply incorrect to regard the *General Theory* as an imperfectionist account, in the neo-classical tradition, postulating a market-clearing equilibrium which is unfortunately frustrated (by the persistence of sticky wages or the operation of a liquidity trap) in doing the trick." Clarke, 324.
22. The confused misinterpretations one finds in today's macro courses are largely due to Oscar Lange, "Say's Law: A Restatement and Criticism," in O. Lange et al., *Studies in Mathematical Economics and Econometrics* (Chicago: University of Chicago Press, 1942); this is discussed by Axel Leijonhufvud, "Say's Principle," 97–9. Leijonhufvud maintains (99) that "In this part of his argument, Lange is guilty not only of repeated sins of verbal sophistry but also of gross historical inaccuracy."
23. Frank Hahn and Joan Robinson, respectively, have used these terms, according to Moggridge, 162n.
24. Joan Robinson, "What has become of the Keynesian Revolution?," in Robinson, *After Keynes* (Oxford: Basil Blackwell, 1973), 3; cited in Coddington, 1962.
25. Henry Hazlitt, *The Failure of the 'New Economics'* (Princeton, N.J.: Van Nostrand, 1959), 9: "Keynes's main 'contributions' are demonstrably wrong, and in those cases in which he is saying something that is true he is indeed saying nothing new." W. H. Hutt, *Keynesianism*, 11: "It is only confusing to suggest that Keynes was partly right and partly wrong. I shall maintain that where he was right, he was not original, and that where he was original he was wrong." David C. Colander, ed., *Solutions to Unemployment* (New York: Harcourt Brace Jovanovich, 1981), 7, attributes the following, without citation, to Frank Knight: "Keynes said some things that were new and some things that were true. Unfortunately the things that were new weren't true and the things that were true weren't new." Keynes tried to shield himself from such critics in the *General Theory* (v): "Those, who are strongly wedded to what I shall call 'the classical theory', will fluctuate, I expect, between a belief that I am quite wrong and a belief that I am saying nothing new."
26. Friedrich A. Hayek, *The Pure Theory of Capital* (Chicago: University of Chicago Press, 1941), 433–9.

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27. D. H. Robertson, "Alternative Theories of the Rate of Interest: Three Rejoinders," part 2, *Economic Journal* 47, no. 187 (September 1937): 431.
28. W. H. Hutt, *Keynesianism*, 29; Frank H. Knight, "The Business Cycle, Interest, and Money—A Methodological Approach," *Review of Economic Statistics* 23, no. 2 (May 1941), reprinted in Knight, *On the History and Method of Economics* (Chicago: University of Chicago Press, 1956), 222; Arthur W. Marget, round-table discussion of "The Present State of Interest Theory and Mr. Keynes," *American Economic Review* Supplement (March 1938): 72.
29. D. H. Robertson, "Mr. Keynes and the Rate of Interest," *Essays in Monetary Theory* (London: P. S. King, Ltd., 1940), reprinted in Fellner and Haley, 425.
30. Don Patinkin, "Price Flexibility and Full Employment," *American Economic Review* 38 (1948): 543–64. Reprinted in Friedrich A. Lutz and Lloyd W. Mints, eds., *Readings in Monetary Theory* (Homewood, Ill.: Richard D. Irwin, Inc., 1951), 252–83.
31. It is also interesting that Hicks and Samuelson, two prominent developers of the "neoclassical synthesis" view of Keynes, both played important roles in the shaping of modern neoclassical microeconomic theory.
32. Bruce C. Greenwald and Joseph E. Stiglitz, "Examining Alternative Macroeconomic Theories," *Brookings Paper on Economic Activity* 1 (1988): 207: "We believe that new Keynesian theories—particularly those focusing on the consequences of imperfections . . . provide the best available explanation." "By 'imperfections,'" they explain in a footnote, "we mean deviations in these markets from that characteristic standard, neoclassical markets with perfect competition and perfect information."

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Paul Davidson

THE ECONOMICS OF IGNORANCE OR IGNORANCE OF ECONOMICS?

THE ECONOMICS OF TIME AND IGNORANCE
by Gerald P. O'Driscoll, Jr. and Mario J. Rizzo
New York: Basil Blackwell, 1985. 261pp., $34.95

O'Driscoll and Rizzo, two leading exponents of the Austrian subjectivist school of economics, claim to provide an original and powerful challenge to mainstream neoclassical economics. They also argue that there is much common ground between the Austrian approach and the recent development of Post Keynesian analysis. In this essay, the validity of such claims is analyzed, and the shortcomings of the Austrian school's approach vis-à-vis Post Keynesian and neoclassical analysis is developed.

The dust jacket of *The Economics of Time and Ignorance* by Gerald P. O'Driscoll, Jr. and Mario J. Rizzo [hereafter O&R] boasts that "Austrian subjectivist economics constitutes the most original and powerful challenge to mainstream neoclassical economics." We all expect puffery on book jackets, but, as I will explain below, these claims are completely unjustified.

O&R, two leading exponents of "Austrian subjectivism," ultimately develop a model of Social Darwinism via the marketplace; this same theme is a major motif of mainstream neoclassical economics. This similarity is not surprising, since both the Austrian and mainstream neoclassical models share many of the same fundamental axioms. Accord-

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ing to O&R, the major flaw in the mainstream neoclassical system is the unreality of its "clockwork model" which automatically and costlessly assures simultaneous market clearing via the finding of a market vector of prices that coordinates all the plans of individuals. This costless mechanism, according to O&R, is delusive for it requires economic agents to possess a level of knowledge about the real world that they cannot afford to obtain.

The Austrians argue for a Hayekian definition of equilibrium "in terms of the compatibility of individual plans" (80), though they offer a dynamic modification of this Hayekian concept by invoking "pattern coordination," where "the plans of individuals are in pattern equilibrium if they are coordinated with respect to their typical features, even if their unique aspects fail to mesh" (85). Despite this ambiguous prose, it is obvious that market clearing is an essential condition for O&R's "pattern coordination" concept. Arrow and Hahn (1971), however, have proven that in an economy in real time and where contracts are made in terms of money, there need never exist any market solution which can coordinate all individuals' plans and clear all markets simultaneously. In other words, *the mere presence of real time and money can jeopardize the very existence of any plan-coordinated equilibrium outcome!* Of course, a world without global plan compatibility and coordination is the general theory developed by Keynes and the Post Keynesians: a world where a competitive market will not automatically assure full-employment equilibrium, even in the long run.

The Austrians have made the existence of real time and uncertainty, and the institution of money, the essential building blocks of their attack on mainstream economics *and* the basis of their own analysis. Accordingly, the Arrow-Hahn results must cast considerable doubts on the Austrian presumption that there always exists the possibility of a plan-coordinated equilibrium that is just waiting to be discovered by entrepreneurs in a competitive market economy. Austrian subjectivists cannot have it both ways—they cannot argue for the importance of time, uncertainty, and money, and simultaneously presume that plan or pattern coordination must *exist* and is merely waiting to be discovered. The very aspects of orthodox neoclassical analysis that the Austrians repudiate, its timelessness and absence of "genuine" uncertainty, are the guarantors of the existence of an equilibrium where individuals' plans are compatible. O&R's rejection of these attributes while still claiming the possibility of full-employment—plan-coordinated—equilibrium is equivalent to accepting the grin without any evidence of the existence of a Cheshire Cat.

O&R state that knowledge about the future is not evenly distributed, i.e., "Not all individuals know or do the same things" (22). In this dynamic

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Austrian approach, agents—especially entrepreneurs—are continually striving to learn from (presumed) currently existing information how to coordinate the plans of all members of society as they search for "possible opportunities for gainful action. . . . The *process* of entrepreneurial learning is neither determinate nor random. In fact, this is the fundamental assumption of the theory of entrepreneurship. We are willing to say *a priori* that learning will take place" (38), and hence a tendency towards pattern coordination will occur. But, in a world of real time and money, how can entrepreneurs learn, if no such compatibility of plans may exist?[1] The logical power of the Austrian challenge to mainstream economics falters on this point.

What Originality?

Despite the claim of the "most original" challenge to neoclassical analysis, in reality the Austrians have neither logically differentiated themselves from the neoclassical approach, nor raised major problems in it. For example, nearly a dozen years before O&R's book, F. H. Hahn, a leading proponent of neoclassical (Arrow-Debreu) analysis, had already noted that, in the real world of time and uncertainty, the primary purpose of neoclassical analysis is to demonstrate why an optimal allocation of resources and a complete coordination of all plans can *never* be achieved. Hahn states that the neoclassical analysis is

> very useful when for instance one comes to argue with someone who maintains that we need not worry about exhaustible resources because they will always have prices which ensure their proper use. Of course there are many things wrong with this contention but a quick way of disposing of the claim is to note that an Arrow-Debreu equilibrium must be an assumption he is making about the economy and then show why the economy can not be in this state. The argument will here turn on the absence of futures markets and contingency futures markets and on an inadequate treatment of time and uncertainty by the construction. This negative role of Arrow-Debreu equilibrium I consider almost to be sufficient justification for it, since practical men and ill-trained theorists do not understand what they are claiming to be the case when they claim a beneficent and coherent role for the invisible hand. But for descriptive purposes of course this negative role is hardly a recommendation. (Hahn 1973, 14–15)

Hence what the Austrians see as a fault, namely that real agents cannot possess complete information about the future, the neoclassicists see as a

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major strong point and "justification" of their model. Both the Austrians and mainstream economists agree that the neoclassical model is not a good description of reality.

Perhaps O&R's originality lies not in the Hahn argument of insufficient information, but instead in their argument that existing "price signals need not always be correct" (39), and hence that entrepreneurs may take short-run actions which create discoordination. O&R present an hypothetical case (39) where when prices change, agents "mistakenly" relate the change in price to a wrong cause; hence agents undertake a short-run wrong reaction leading to further plan discoordination. This notion, however, has already been developed in the mainstream "sun spot" theories of Azariadis (1981), Cass and Shell (1983), and others, which presume that individuals misinterpret the cause of price changes, and, therefore, take actions which adversely affect the short-run output and unemployment level of the economy. Of course, in the long run, if entrepreneurs learn and therefore obtain sufficient information regarding the future, then they will not make continual "systematic errors," and full employment and plan-coordinated equilibrium will occur in both the sun spot models and the Austrian system.

In a moment of candor, O&R admit that their analysis is not well thought out, for a "vague Darwinian process is postulated, which weeds out institutions [and entrepreneurs?] with inferior survival properties. Unless the nature of these survival properties is made clear, the whole 'theory' is little more than a tautology. Survival properties are, by definition, those attributes that enable an institution to survive. . . . Unfortunately, as the theory now stands, a careful specification of what makes societies survive has not been achieved" (40). Does the claim of the Austrians' "most powerful challenge" to neoclassicism ultimately rest on the flimsy tautological view that, in a world of uncertainty, those institutions and entrepreneurs that possess unspecified survival properties, follow the Darwinian law of the survival of the fittest in the jungle of the marketplace? I do not think neoclassical theory has much to fear if it does.

Post Keynesianism vs. Austrianism

When the editor of CRITICAL REVIEW asked the editor of the *Journal of Post Keynesian Economics* (JPKE) to review *The Economics of Time and Ignorance,* he must have been aware of O&R's statement on p.9:

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> In recent years a largely American branch of the Cambridge (U.K.) school, known as post-Keynesian economics, has arisen to carry forth the subjectivist aspects of Keynes' system. For a long time these had been buried and almost forgotten within the Hicksian neoclassical framework. Now, fortunately, they are being revived and developed. Paul Davidson has conveniently summarized the post-Keynesian perspective in three propositions . . . :
>
> (1) the economy is a process in historical (real) time;
>
> (2) in a world where uncertainty and surprises are unavoidable, expectations have an unavoidable and significant effect on economic outcomes;
>
> (3) economic and political institutions are not negligible and, in fact, play an extremely important role in determining real world economic outcomes.
>
> The reader will be hard pressed to find any significant differences between these propositions and the argument of this chapter. What is even more surprising is that Davidson's explication of the meaning of these propositions increases, rather than reduces, the amount of overlap. It is evident that there is much more common grond between post-Keynesian subjectivism and Austrian subjectivism. Cross-fertilization between the two schools is, however, exceedingly rare, although the possibilities for mutually advantageous interchange seem significant.

Contrary to O&R's declaration, this reader was not "hard pressed" to find many differences between the views of the Post Keynesians and those expressed by O&R as representative of Austrian subjectivism. These differences ranged from trivial distinctions—e.g., as to

(1) the spelling of the Post Keynesian School. O&R use a lower case p and insert a hyphen between Post and Keynesian, which is the way neoclassical synthesis (mainstream) Keynesians such as Paul Samuelson and Robert Solow of MIT spell the school to which they believe they belong. Post Keynesians subscribing to the analysis developed in journals such as the JPKE capitalize the P and do not use the hyphen.

—to fundamental discrepancies such as

(2) using concepts which O&R never "scientifically" define (e.g., the meaning of uncertainty vs. knowledge) or else using phrases (e.g., stages of production [167]) in a manner that only those who are already converts to the Austrian School could readily understand; and

(3) O&R's exclamation that "bad theory" is "theory in which changes in the level of savings are neither a cause nor a consequence of changes in the rate of interest" (184). Since a fundamental tenet of Keynes's and Post Keynesians' analysis involves the relationship of savings to income, rather than the interest rate, it is obvious, according to this Austrian definition of "bad theory," that Keynes's *General Theory* must be bad!

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There is an obvious lack of communication between Post Keynesians and Austrians, and communication must precede any cross-fertilization. I am not surprised that after p. 9 no further mention is made of Post Keynesian analysis. I suspect that O&R have not understood Post Keynesianism. Instead they appear to have scanned the literature for key code words (e.g., "uncertainty," "real time") in order to find areas of verbal overlap. There is no evidence of any effort to study whether there exists any area of analytical overlap.[2]

Consequently, as I read this volume, I often thought that what separates the Austrians from Post Keynesians is comparable to what one wag said separates England and the United States: "a common ocean and a common language."

How shall I proceed? The most constructive way is to explain, despite the Austrians' emphasis on uncertainty, historical time, money, etc., (a) why their views on these notions have little or no relationship to their meaning as developed by Keynes and the Post Keynesians, and (b) why Austrian notions pose little or no threat to the mainstream.

Paradigm Differences

Keynes declared that the difference between neoclassical economics and his "general theory" was similar to the difference between Euclidean and non-Euclidean Schools of geometry—a different axiomatic basis. He wrote that neoclassical theorists

> resemble Euclidean geometers in a non-Euclidean world who, discovering that in experience straight lines apparently parallel often meet, rebuke the lines for not keeping straight—as the only remedy for the unfortunate collisions which are occurring. Yet, in truth, there is no remedy except to throw over the axiom of parallels and to work out a non-Euclidean geometry. Something similar is required in economics today. (Keynes 1936, 16)

Hence for Keynes, a "throw over" of some highly restrictive axioms was the basis for the difference between his analysis and neoclassical theory. As I have discussed elsewhere (1984), the Keynesian Revolution required the removal of three such axioms, those of money neutrality, ergodicity, and gross substitution. Unhampered by these restrictive presuppositions, Keynes and the Post Keynesians developed different answers to the important questions that all reasoning people ask of economists, namely,

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What causes unemployment? What causes inflation? And how do we cure these maladies of the capitalist system without destroying capitalism?

Contrary to Keynes's view of the basis of differences in schools of economic thought, O&R claim that the only thing that "separates schools in science is the questions posed, not the answers given" (229). Consequently one should not be surprised that the Austrians—despite their supposed provocative challenge to neoclassical analysis—provide the same Panglossian answers to these burning questions, maintaining that a laissez-faire competitive market will result in the best of all possible worlds, one tending towards full employment (plan coordination) without inflation.

If two schools share the identical axiomatic foundation—as the Austrians and mainstream neoclassical economists do—then if they ask the same questions, they should reach the same answers, unless one school has made a mistake in logic and/or has introduced ad hoc constraints on the operation of the system. No wonder, then, that after 230 pages O&R declare that "it should not be surprising if there were substantial overlap between Austrian or subjectivist economics and neoclassical orthodoxy" (231).

"Our purpose in writing this book," O&R explain, "was to restate and advance subjectivist economics. This goal would scarcely have been promoted by presenting an exhaustive list of neoclassical propositions with which we agree. . . . If, however, we were to characterize the subjectivist literature generally, we would have to admit that it has been relatively long on methodological prescriptions and short on applications" (231). Apparently, then, the Austrian challenge is not to the logical syllogisms from which neoclassical answers follow; for the Austrians are trapped by the same axioms and must reach the same conclusions. Their argument with the neoclassicists is over whose parable is a more descriptive fable to illustrate the same Panglossian view of the competitive market system.

The Three Restrictive Axioms of Neoclassical Analysis

Till now I have merely asserted that the Austrians and mainstream neoclassicals share the same axioms. Let me now document this contention. O&R accept the Austrian Carl Menger's definition of *money* which "involve[s] commitments in the form of commodity inventories" (188). This definition reduces money to a commodity basis—and hence it is based on the money neutrality axiom, where the coordination of individual plans for the demand and supply of real goods and services is

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independent of the nominal supply of money. Keynes (1933), on the other hand, declared that in reality, money was *never* neutral.

O&R's use of Hayek's definition of *equilibrium* in terms of the compatibility of individual plans, even when they modify it to represent "pattern coordination" (85), means that there must exist a vector of market prices which is consistent with market equilibrium. A sufficient conditon for this to occur is if all excess demand curves are downward sloping and hence well-behaved—a condition that implies the gross substitution axiom, where every good (and service) is a gross substitute for every other good (or service). Keynes (1936, 229–42), on the other hand, specifically noted that the elasticity of substitution between durables that are liquid assets and real producible (and illiquid) goods is approximately zero, i.e., illiquid real capital goods are not gross substitutes for liquid assets in the portfolio of savers. Hence in the Keynes/Post Keynesian analysis the axiom of ubiquitous gross substitution is not applicable.

In both Keynes's and Post Keynesian eyes, the Austrians are still utilizing the logical foundations of "Euclidean" neoclassical analysis. They have not overthrown the neutrality and gross substitution axioms and hence are incapable of producing a logical alternative to neoclassical economics.

Is Unemployment Equilibrium?

Hayek's definition of equilibrium in terms of the compatibility of plans (including those in the labor market!) means that Keynes's underemployment equilibrium (where some workers' willingness to work at the going wage is not coordinated with employers' hiring plans) must be a "bad theory." Keynes's *General Theory* of the possibility of continual unemployment is incompatible with Austrian economics where "versatile resources [labor?] ought not to be persistently unemployed" (198).

In Keynes's "non-Euclidean" economics, where the restrictive axioms of neoclassical economics are thrown over, persistent unemployment with persevering labor-market plan incompatibility is a perfectly possible equilibrium outcome. For Keynes, less than full-employment equilibrium merely meant that though workers are thwarted in their plans to work, there need not be any market forces to increase labor hiring by business firms. No market coordination of entrepreneurial and workers' plans may be possible, according to Keynes, and hence there is a role for government to create conditions in which full employment equilibrium can occur—and then permit entrepreneurs to discover the way.

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Keynes, as a student of Marshall, used the Cambridge definition of equilibrium—rather that the Hayekian one—as that point where neither buyers nor sellers attempt to change the outcome; as Patinkin (1965, 643) puts it, equilibrium means "in the usual sense of the term that nothing tends to change in the system." Even O&R (51 n2) admit to using the term equilibrium "in the sense of no tendency to change" at times.

Finally, since O&R assert that "there is no reason to believe that entrepreneurs will be *systematically* in error" (180), they are accepting the rational expectations hypothesis of neoclassical economics, which is based on the axiom of ergodicity[3]—an axiom which Keynes implicitly rejected (1939) in his famous criticism of Tinbergen's econometric methodology.

The Concept of Uncertainty

From a Post Keynesian view, there are many unsatisfactory aspects of O&R's discussion which prevent it from being a serious challenge to mainstream orthodoxy. In the limited space remaining, I will only focus on a few of these features: (1) the meaning of the concept of uncertainty; (2) the role of contracts and money in an uncertain world; and (3) the rate of interest as a monetary vs. real phenomenon.

(1) O&R lack a technical definition of uncertainty. According to them, since "adjustments" to shocks require real time,

> knowledge can grow and novel outcomes can emerge. Real time also affects the characterization of uncertainty. Risk analysis, whether objective or subjective, is essentially the weighing of possibilities already known. Genuine uncertainty, however, allows for unpredictable growth of these possibilities and thus for "gaps" in agents' probability distribution.

How does this view differ from the concept of uncertainty in neoclassical models, and uncertainty as defined in Post Keynesian economics? For mainstream economists, probabilistic risk and uncertainty are synonymous. For Post Keynesians, uncertainty involves an incalculable future.[4] For O&R, on the other hand, uncertainty only involves currently unthought-of possibilities, i.e., "an open-ended set of possibilities" (66) regarding future outcomes.

Let us see what these three views regarding uncertainty mean in a hypothetical situation. Suppose we tell an agent that I am going to toss a two-sided coin—and that this coin would either (a) have two heads, (b)

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have two tails, or (c) have a tail and a head. If I then toss the coin, since *all the possibilities* are already known, the agent would face no Austrian uncertainty as to the forthcoming coin toss.

For mainstream neoclassical economists, the uncertainty of this coin toss would be expressed via Bayesian priors of equal probabilities regarding a head or a tail toss. For Keynes and the Post Keynesians, on the other hand, unless the agent were told whether coin (a), (b) or (c) was tossed, he would have no basis upon which to calculate a probability – and hence he would face uncertainty. The average layperson would also think that the outcome of such a coin toss is genuinely uncertain.

Obviously, the Austrian concept of uncertainty is insufficient to cover even this simple case of uncertainty. O&R merely associate "genuine" uncertainty with "unpredictable growth in possibilities" (65–6) rather than offering a technical definition of uncertainty. Many economists tend to dismiss such efforts to introduce such a vague concept of uncertainty into economic analysis as merely hand-waving, or, in Coddington's (1982, 486) words "no theory at all . . . nihilistic."

A failure to frame one's analysis in terms of the "scientific" dialect used by the majority of economists means that the Austrian approach cannot be evaluated in terms that "mainstream neoclassical" economist-scientists utilize to judge their own models. If members of the Austrian School use code words as a substitute for analysis, the Austrian view can easily be ignored as an idiosyncratic backwater of economics and it will never be taken seriously as a "powerful challenge to mainstream neoclassical economics."

Keynes, on the other hand, attempted to engage in a scientific dialogue with his "fellow economists" (Keynes 1936, v) in order to show that his analysis was a "General Theory" and that the neoclassical analysis was a special case (*ibid.*, 3) involving some very restrictive axioms. Keynes attempted to persuade his professional colleagues to "re-examine critically certain of their basic assumptions. . . . If my explanations are right," he recognized, "it is my fellow economists, not the general public, whom I must first convince" (*ibid.*, vi). This strategy of challenging the mainstream has been consistently followed by the Post Keynesians, whether they are discussing the existence of production functions and the possibility of "reswitching" or the role of money, time and uncertainty in the economic system.

Unlike the Austrians, then, the Post Keynesians have attempted to engage in a constructive dialogue with the economic mainstream by framing their concepts in orthodox vocabulary without accepting some of the underlying postulates. The Austrians, on the other hand, have

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accepted *all* the underlying fundamental axioms of neoclassical analysis, but have built ad hoc changes via a vocabulary that uses the same words, but endows them with eccentric and often unexplained meanings, to achieve results that do not follow from the basic neoclassical premises. This is especially obvious in the case of the Austrian concept of uncertainty—for it is only the claimed presence of unexplained "gaps" in probability distributions which acts as an ad hoc constraint on achieving the logical result of neoclassical postulates. Compare this "gaps" approach to uncertainty with the Post Keynesian argument.

The Ergodic Axiom

In the mainstream view of economics as a science, economic observations are postulated to be part of time-series realizations generated by stochastic processes—non-deterministic processes from which, nevertheless, probabilities can be derived—which are assumed to be ergodic. This assumption means that implications for future probabilities are calculable from historical economic data. Samuelson (1969, 184) has made the acceptance of the "ergodic hypothesis" the *sine qua non* of the scientific method in economics. When an economist of the stature of Samuelson defines what is scientific in terms of ergodic processes, it is not an exaggeration to suggest that most economists accept this view. Consequently, the orthodox concept of *"scientific" economic knowledge about the future relationship among observable economic variables* is defined in terms of the probability distribution functions and statistical averages generated by ergodic processes. Since, under the ergodic axiom, probability provides knowledge regarding the future, not uncertainty, knowledge's inverse, *uncertainty regarding real world future events* (Shackle's [1972] "unknowledge"), must also be defined in terms of the theory of ergodicity—if it is to be unassailable by orthodox economist-scientists cum Samuelson.

Knowledge, Stochastic Processes, and Uncertainty

Knowledge regarding the relationship among economic variables may depend solely on logic, or it may be influenced by empirically observed relationships; ultimately, one hopes, useful knowledge regarding the real world will be both logically and empirically based.

If *knowledge* regarding economic relationships is based solely on logic and does not have any (as yet) empirical support, then it must be grounded

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entirely on a syllogism that does not violate any of the laws of logic. Such knowledge, drawn from a set of premises or axioms, contains no more information than the premises taken collectively. It is deductive, definitional, and can be reflected in a truism. Logically based knowledge without any empirical foundation, i.e., axiomatic knowledge, is, once discovered, platitudinous as well,[5] e.g., knowledge that the behavior of profit-maximizing entrepreneurs involves their equating marginal revenue with marginal costs.

When we speak about possessing *knowledge in the real world* that we inhabit, as opposed to a world we define solely via everlasting logical relations, then this knowledge must have an empirical basis. Usually this empirical knowledge about real-world relationships is quantitative and is described via statistical averages which have been calculated from past (and/or current) times series and/or cross-sectional data.[6]

All stochastic (probabilistic) processes generate times-series data (realizations) which can be used to form averages. These averages (e.g., the mean, standard deviation, etc.) form the pattern basis for empirical knowledge about our past and current relationships. *Time averages* refer to statistics calculated from a single realization over any period of calendar time. *Space averages,* on the other hand, are statistics formed over a universe of realizations observed at a fixed point in time (i.e., estimates from cross-sectional data).

If the stochastic process which generates the realization is *ergodic,* then, by definition, for infinite realizations, the space average and the time average will coincide. For finite realizations the calculated space and time averages may differ due to sampling error, but they will tend to converge (with the probability of unity) as the number of observations increases. In the case of ergodic processes, therefore, the probability distribution of the relevant variables calculated from any past realization tends to converge with the probability function governing current events *and* with the probability function that will govern future economic outcomes.

In an economic world governed entirely by ergodic processes, therefore, economic relationships among variables are timeless, or ahistorical in the sense that the future is merely a statistical reflection of the past. The historical dates when observations are collected do not affect the estimates of the statistical averages. The accumulation of past evidence regarding economic outcomes allows the calculation of statistical averages which can then be used to make statistically reliable statements regarding the mathematical risk or probability of events occurring in the future. In other words, *in an ergodic environment, knowledge about the future involves projecting statistical averages based on past and/or current realizations to forthcoming events.*[7]

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Thus when O&R claim that "there is no reason to believe that entrepreneurs will be *systematically* in error" (180), they are using the same assumption that rational expectations advocates do when they claim that decision makers will not be *persistently* in error. Non-systematic errors and non-persistent errors imply only random errors, so there is the assumption that past patterns (as recorded in times-series realizations or cross-sectional data) provide statistically reliable information about future events. Thus if the economic world is ergodic we can be sure that entrepreneurs can learn from past and present patterns and not make either persistent or systematic errors. In a nonergodic environment, however, there is no mechanism to assure the avoidance of systematic and persistent errors.

Scientifically speaking then, as Samuelson does, *uncertainty about the future* involves a nonergodic economic environment. In a nonergodic world, past observations cannot produce information regarding current and/or future events; current patterns provide no statistically credible estimate of future time and/or space averages.[8]

In a nonergodic world, people "do not know what is going to happen and know that they do not know just what is going to happen. As in history!" (Hicks 1977, vii). Unlike the Austrian concept, Post Keynesian uncertainty need not be limited to "gaps" in the current probability (subjective or objective) distribution. Uncertainty implies that economic decision makers recognize that today's probabilities (if any) will not govern the future outcomes.

As long as decision makers believe they operate in a nonergodic environment, they "know" that those who hesitate are saved from making a decision until another day. The desire to postpone commitments varies with a person's assessment of the current situation and perception of the uncertain future. People do, of course, recognize that certain commitments have to be made even if the future cannot be reliably predicted on the basis of past and current patterns. As we will explain *infra,* in a money economy moving through real time, the use of the human institution of money contracts (i) permits the parties, in a nonergodic environment, to legally assure a future outcome in terms of performance and payment, while (ii) jeopardizing the possibility of the free market achieving global plan coordination.

In undertaking specific money contractual commitments, *only* the possession of sufficient liquidity to meet these obligations and to be able to take advantage of unforeseen opportunities, can lull people's distrust of their "own calculations and conventions concerning the future" (Keynes 1937, 116). Thus, the human propensity to use some portion of

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current earnings to purchase (and maintain) liquidity (idle balances for precautionary and speculative purposes) instead of committing income completely to the purchase of currently producible goods and services reflects *sensible* behavior[9] by decision makers (in an non-ergodic world), a behavior which negates Say's Law and permits plan discoordination to persist.

Money and Contracts in a Nonergodic World

It is only in a nonergodic economic world that the concept of uncertainty about the future can be technically defined as differing from risk. In such a world, as I have demonstrated elsewhere (Davidson 1978, 1982–83, 1984; Davidson and Davidson 1988), the existence of *explicit* money contracts, as the basis for efficiently organizing time-consuming production and exchange processes, provides some assurance to the contracting parties that they have the ability to determine future outcomes, while money itself permits flexibility and freedom to respond to unpredictable future events.

Although lower life forms enter into organizational and societal structures (e.g., beaver and ant colonies, schools of fish, herds of elephants, etc.) for the efficient operation of production and consumption processes, none of these lower animals' activities are driven by "animal spirits" *interacting* with forward contracts, money, and markets to achieve the objectives of the species in question.

Only humans have evolved the institutions of *explicit* legally enforceable forward money contracts to assure legal future outcomes of performance and payment where the future is uninsurable and conflicts can arise after a "meeting of the minds" (i.e., a contract curve solution) between the contracting parties. When the uncertain future becomes the actual present, sometimes parties to contractual agreements will discover that they are *unwilling and/or unable* to deliver on their *explicit* contractual obligations.[10]

Each party to a forward contract recognizes at the time of signing that the other party, despite possessing good faith at the time of signing, may not execute the contractual terms at the specified date. Legal enforcement of contracts permits each party to sensibly expect that if the other party does not fulfill its obligation, the injured party is entitled to just compensation and hence will not suffer a pecuniary loss. Thus as long as the legal system of contract law remains in force, entry into forward hiring and material purchase contracts permits entrepreneurs to control (and therefore predict) their legal future cash outflows while assuring the availability

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of inputs for production in an otherwise uncertain future.[11] If the entrepreneur-producer already possesses the liquidity to finance these contractually controlled production costs (or he can borrow the liquidity from his banker), then he not only "knows" that he can efficiently organize the long duration production process, but also that he has the financial wherewithal to carry out the production process to its successful completion.

The ability of the banking system to create "real bills" to finance *increases* in production flows is, therefore, an essential expansionary element in the operation of a (non-neutral) money production economy.[12] If entrepreneurs cannot obtain additional bank money commitments when, in the aggregate, they wish to expand their production flows (and the liquidity preference of the public is unchanged), then entrepreneurs will not be able to meet their additional payroll obligations before the additional output is completed and sold. Accordingly, in the absence of the creation of bank money, entrepreneurs will not be willing to sign additional hiring contracts—and long-run employment growth will be stymied, even when expected future effective demand is sufficient to warrant expansion. In this situation money is not neutral, for a shortage of money can hold up the expansion of real output.

If, on the other hand, an entrepreneur can obtain sufficient liquidity from the banking system to finance expansion in working capital, then his only (and not insignificant) worry then is whether he can profitably sell the product at its future gestation date,[13] thereby liquidating his position in working capital and assuring his ability to begin a new production cycle.

In the absence of money production-hire contracts over time in a nonergodic environment, entrepreneurs would be foolish to start up a long duration production process, for they would not possess any knowledge of the ultimate future costs of production. (How could a profit-maximizing manager calculate the marginal costs associated with varying production flows, in a nonergodic world, without fixed nominal contracts?) The institution of forward money contracts where delivery and payment are specified at a future date is an institutional arrangement which permits agents to deal with, and control the outcomes of, an otherwise uncertain future. Long-lived forward contracts are the way a free-market economy, in an uncertain world, builds in institutional price and wage controls over time. In a nonergodic world, such explicit money contractual anchors for future events are necessary conditions for encouraging entrepreneurs to carry out economic activities in a market economy.

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In an economy that organizes its production and purchase operations via money contracts, the possession of money and/or liquid assets (i.e., assets readily resaleable for money in well-organized, orderly spot markets) permits the individual to take advantage of currently unforeseeable future opportunities, while simultaneously self-insuring the holder against untoward events. If an individual holds only illiquid real commodities and no money, then the person has "locked" himself into an inflexible course of action no matter what the future may bring. An intermediate position of holding only imperfectly liquid assets (potentially saleable but not in well-organized markets) and no money will limit both the individual's opportunities and his self-insurance against misfortune. Accordingly, even if economic decision makers merely think that future events can be generated by nonergodic circumstances, then the demand for money (as idle balances) and liquidity will be greater than zero, as they sensibly wish to maintain freedom and flexibility of response.

The Nonneutrality of Money

O&R accept the neoclassical argument of the long-run neutrality of money (e.g., 173). Keynes, by contrast, assumed that money was *never* neutral (1933, 408–9). The Post Keynesians have made the short- and long-run nonneutrality of money the backbone of their monetary analysis (Davidson 1978, 1984). Recently, even a staunch "post-Keynesian" (with a hyphen), Nobel laureate James Tobin (1985, 112–3), has recognized that Keynes's unqualified rejection of the neutrality of money in the long- and short-runs was associated with "the essential unpredictability, even in a probabilistic sense" of the future. Thus, for Keynes, the rate of interest is strictly a monetary phenomenon (Keynes 1936, 222) determined by liquidity preference, rather than by time preference *per se* (Keynes 1936, 166). The Austrians, on the other hand, since they accept the neutrality of money, assume that money (as a commodity commitment) and long-lived capital goods are gross substitutes[14] (O&R, 174). Accordingly, the Austrians confuse liquidity preference for time preference (176), and dogmatically assert that "the interest rate, broadly conceived, is synonymous with the rate of time discount implicit in the prices of capital goods and other inputs" (169), as opposed to being the price for giving up liquidity, as Keynes held. For Austrians the gross substitution axiom makes changes in the rate of interest merely alter the pattern of expenditures on productive inputs, while leaving all inputs fully employed. For

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Keynes and the Post Keynesians, on the other hand, a tight money policy can create "permanent" unemployment.

For O&R (181), a "change in time preference," e.g., a decrease in consumer demand, merely releases resources to restructure the roundaboutness of capital; thus, no unemployment occurs. For Keynes and the Post Keynesians, any decline in demand leads entrepreneurs to reduce hiring activity. And as the reswitching controversy indicated, even if this decline in demand leads to a reduction in the rate of interest, there is no logical necessity that a capital deepening technology will be induced. Thus, for O&R, the interest rate is a real factor, while for Keynes and the Post Keynesians, it is strictly a monetary phenomenon.

* * *

In the eyes of this Post Keynesian, the views of Austrian subjectivists are seriously flawed—despite their utilization of such code words as uncertainty, real time, and money. If this Austrian assault is "the most original and powerful challenge to mainstream neoclassical models," orthodox economists need not worry. Fortunately, Keynes started and the Post Keynesians have continued to develop an alternative structure which, like the child in the fable, calls out for all to see that the neoclassical "Emperor is without clothes."

NOTES

1. Oversimplifying slightly, we may characterize the basic neoclassical model as assuming a mechanism where complete information about the future exists and is costlessly distributed to all agents. In the Austrian model, although complete information is presumed to exist, it is costly to acquire. For Keynes and the Post Keynesians, as will be explained below, in an uncertain world information regarding future outcomes does *not* currently exist and hence cannot be acquired at any cost.
2. I should note that O&R's failure to study analytical similarities and differences extends to the theoretical arguments of other [non-Austrian] economists who also claim to use a subjectivist approach. For example, the authors apparently believe that subjective probability theory is inapplicable to unique events (e.g., 78–9). Yet others, e.g., Ramsey (1931), de Finetti (1937, 1974), Savage (1954), and Pratt, Raiffa and Schlaifer (1964) claim that subjective probabilities are applicable to both repetitive and unique events. No mention is made of this "subjectivist" view of probability and its claimed applicability to unique events.
3. As note 1 suggests, subjective probability theorists such as Savage would take exception to this statement.

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4. Keynes (1937, 113) associates uncertainty with a situation where "there is no scientific basis on which to form any calculable probability whatever. We simply do not know." Keynes specifically rejected the use of Bayesian priors (1936, 153) in such cases.
5. This is not to deny that the conclusion reached may not have been obvious prior to its logical discovery.
6. It is possible to have non-quantitative empirical knowledge about the past, e.g., knowledge that fire generates heat. Normally, however, such qualitative information, to be "scientific," would be converted into a quantitative relationship by calculating the probability of fire generating heat as the ratio of the number of times heat was observed divided by the number of times a fire was observed.
7. As Billingsley (1978, 1) stated, if "the laws governing . . . change remain fixed as time passes . . . [then] ergodic theory is a key to understanding these fluctuations." Whenever the "passage of time does not affect the set of joint probability laws governing experimentation (outcomes), then the assumption of ergodicity permits regularities to be perceived from what might at first sight be patternless fluctuations" (*ibid.*, 2; also see 60–5). This past pattern of regularities can then be reliably projected into the future.
8. If the distribution function is not independent of historical time, i.e., if the passage of time affects the joint probability laws, then history matters. One type of such an historical process is labelled nonstationary by statisticians. Solow (1985, 328) insists that "much of what we observe cannot be treated as the realization of a stationary stochastic process without straining credulity." Nonstationarity is a sufficient, but not a necessary condition, for nonergodicity.

   Some stationary stochastic processes can be nonergodic, e.g., limit cycles. An example of an economic limit cycle would be an accelerator-multiplier trade cycle model with ceilings and floors (see Davidson 1982–83, 186–7). Hence the future can be uncertain even in a world of stationary stochastic processes—i.e., even in the absence of structural breaks and/or periods of crises.
9. Sensible behavior is not "rational" in the neoclassical sense of optimizing the intertemporal consumption of producible real goods. Liquid assets such as money are non-producible (by the use of labor in the private sector) goods (see Keynes 1936, ch. 17; Davidson 1978, chs. 6–9). Money is not, therefore, a commitment to commodities, as the Austrians would claim. When held for precautionary and/or speculative purposes, liquid assets provide utility by protecting the owner, in a monetary production economy, from adverse, statistically unpredictable, events. The utility value of possessing liquid assets, in an uncertain world, is not the present value of a utility index for the consumption of some specific future consumption goods at a specific future date. Rather it is the value of preserving flexibility for future actions! Current utility flows associated with liquidity holdings which protect and insure

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holders from unpredictable outcomes are omitted from the preference functions of inhabitants of an ergodic neoclassical or Austrian world where the absence of systematic errors would make such long-run liquidity demands superfluous.

10. In the real (nonergodic) world – unlike the ergodic neoclassical paradigm – recontracting *without income penalty* whenever a buyer or seller has made, in hindsight, a contractual error is simply not permitted.
11. O&R deny the need for a law of contracts when they accept Menger's claim that money can be adopted "without legal compulsion" (192). Does any reader seriously believe people would hold money if there were not legal enforcement of money contracts? After all, liquidity means the ability to meet your legal contractual obligations as they come due. Without "legal compulsion" to enforce contracts there is no need for liquidity or for money, for one does not have to meet contractual commitments as they come due!
12. In a revision of his famous Keynesian Counter-Revolution article, Clower recognized the fact that the creation of "real bills" must precede increases in economic activity (and therefore money cannot be neutral). He argued that it is "implicit in this entire line of argument that at some 'initial' stage in the evolution of market trading arrangements, the marketing [monetary?] authority advances a nominal quantity of book [bank?] credit to one or more of the transactors to set the trading process in motion (without such initial advances, no sales order could ever be executed since no purchase order would ever be validated)" (Clower 1969, 289). Of course, every repayment of the credit advanced by the authority must *immediately* be lent out again if activity is to be maintained, otherwise the sales order receipts that are used to pay back the advance are unavailable to validate an equivalent purchase order. But then every increase in activity (not only the increase from an initial zero level activity) must also be *preceded* by additional bank money creation, if the public's liquidity preference is unchanged.
13. Of course, if the entrepreneur has sold his product via a forward money contract at the same time as he has entered into input-hire contracts, then he has contractually assured all his future cash inflows and outflows. In so doing the entrepreneur has, via legal compulsion of the law of contracts, rendered certain the future cash flows and profitability of the undertaking despite operating in an inherently uncertain future.
14. Thus accepting the gross substitution axiom of neoclassical theory. Keynes, on the other hand, indicated that the attribute of liquidity was associated only with money and certain non-producible liquid assets that possessed an elasticity of substitution of approximately zero with producible real capital (see Keynes 1936, 241 n1; Davidson 1978, 1984).

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Lowell Gallaway and Richard Vedder

THE KEYNESIAN PERFORMANCE

PROSPERITY AND UPHEAVAL:
THE WORLD ECONOMY 1945–1980

by Herman Van der Wee

translated by Robin Hogg and Max R. Hall

Berkeley: University of California Press, 1987. 621pp., $14.95

Van der Wee uncritically accepts that Keynesianism is responsible for post-war economic stability. Against this belief, it is argued that an analysis of the historical record shows no significant efforts at countercyclical fiscal management in the post-war era, while efforts to control the economy via monetary policy were associated with increasing instability, culminating in the crisis years of the 1970s. Thus, in the American case at least, post-war stability has been the result of self-correcting market tendencies, while instability has followed government macroeconomic intervention.

Prosperity and Upheaval is a noble effort, broad in scope, replete with the trappings of a serious scholarly endeavor, and dealing with an important subject—the behavior of the economies of the West in the third of a century following World War II. But, in the end, it seems to come apart, to slip away elusively into the superficiality of much of what has passed as sophisticated economic analysis over the last half century. Herman Van der Wee's problem is a familiar one for scholars. In order to organize and interpret complex phenomena, it is useful to have an intellectual paradigm, a framework within which the available information can be arranged and ordered in a systematic fashion. However, this business of employing paradigms is a delicate thing, especially when invoking one of near mythical proportions. The dilemma is a simple one. Which will dominate,

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the scholar or the paradigm? Will the interpretive framework be the analyst's servant or master?

The further one reads in *Prosperity and Upheaval,* the more apparent it becomes that the paradigm has asserted control. Nowhere is this more obvious than in chapters 7 and 8. The first of these is largely a rhapsodic paean to John Maynard Keynes's theoretical contribution to the emergence of the mixed economy. It begins simply enough, with a ritualistic restatement of the proposition that the high levels of unemployment associated with the Great Depression of the 1930s showed once and for all an inherent tendency toward failure in market economies, a demonstration that led to a "complete break with the past," rendering "Adam Smith's idea of 'the Invisible Hand' that regulated the market automatically and flexibly . . . out of date" (283).

Van der Wee is simplistic here, maintaining that "the exclusive system of free-market organization which had been adhered to almost religiously for nearly two centuries was now, as a principle, renounced" (286). The transition he speaks of cannot be described in such hard and fast terms. The winds of change had been in the air well before the onset of the Great Depression, in fact contributing to its intensity and duration.[1] Nevertheless, the early 1930s do represent a watershed in the history of ideas in the West, a crossroads in a very real sense. Turmoil abounded, both in the real world and in that mystic arena in which intellects distill their thoughts, imposing their conceptual notions on the apparent disorder they see about them, that is, postulating new paradigms.

The Classical Paradigm

To be sure, there was a set of ideas that can loosely, albeit very loosely, be called the conventional wisdom of the age. It is embodied in the analytical work of Arthur Cecil Pigou; the essence of how it deals with the phenomenon of unemployment, the pressing problem of the time, is summarized by Abba Lerner in a passage written in 1936: "The reduction of wages . . . will make industrial activity more profitable so that business men will employ more people. As long as there is any unemployment, wages will fall, profits rise; and as profits rise, employment increases until all the unemployed are absorbed in industry, and we have equilibrium and no more unemployment."[2]

Granted, Lerner has somewhat distorted Pigou's position by ignoring what he called "frictional" or "transitional" unemployment. However, allowing for that shortcoming, his statement is a reasonably accurate

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representation of the "classical view." Lerner, of course, is one of the gathering wave of economists who rejected this position and accepted either the entirely opposite argument—that the cure for unemployment is increases in money wage rates—or a more neutral view, that there is no relationship between money wage rates and levels of unemployment. The first of these positions is the underconsumptionist thesis, historically a doctrine that lay outside the pale of mainstream economics,[3] but one that had acquired a certain degree of public acceptance in the 1920s.[4]

But the important thing is that the classical view of the relationship between money wage rates and employment was under attack from within the economics establishment. The rapid deterioration of the world's economies in the early 1930s offered what seemed to many to be *prima facie* evidence that the intellectual basis of the "old order" was no longer adequate. The very chaos of the era prepared the ground for the implantation and flourishing of new ideas—with the premium being on "newness" and not necessarily correctness.

The Keynesian Revolution

The seed that fell on this rich soil was of quality stock, coming from the pen of the preeminent economist of the time, Keynes. It came in the form of what has been known ever since as simply *The General Theory*.[5] Its very name conjures images of greatness and a sense of grand intellectual conquest. Since the ideas in *The General Theory* had been circulating at the higher levels of the intelligentsia, many of them could have been set down by other economists; not, however, with the same impact. Keynes's name and reputation added a special sparkle to the revision of established ideas, particularly among the young. In 1947, Paul Samuelson reflected that "*The General Theory* caught most economists under the age of 35 with the unexpected virulence of a disease first attacking and then decimating an isolated tribe of south sea islanders. Economists beyond fifty turned out to be quite immune to the ailment. With time, most economists in-between began to run the fever, often without knowing or admitting their condition."[6]

"Fever" is the appropriate word. *The General Theory* swept through both England and the United States, producing adherents by the score, even converting some previous devotees of the classical view to the "new Economics." Again, Samuelson's recollections of the time are intriguing. He refers to "the rapidity with which English economists, other than those at Cambridge, took up the new Gospel: e.g., Harrod, Meade, and others

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at Oxford; and still more surprisingly, the young blades at the London School, like Kaldor, Lerner, and Hicks, who threw off their Hayekian garments and joined in the swim."[7]

It was the same in the United States. The young Samuelson, the older Alvin Hansen, who recanted his classical views to become the pedagogical inspiration to a long line of graduate students, and the Austrian-leaning Gottfried von Haberler are cases in point.[8] Everyone, it seemed, was being swept along by the currents of intellectual innovation. The few recalcitrants for the most part were relegated to the category of "eccentrics" or "cranks." In one of the most unfortunately timed acts of publication in the history of the discipline of economics, W. H. Hutt's *Economists and the Public,*[9] arguing quite a different position than *The General Theory,* also came into print in 1936, only to be submerged by the Keynesian tide. Ludwig von Mises maintained the faith,[10] as did Hayek and Hutt.[11] But when Keynesianism was in flower, any who did not move with the crowd were characterized as antediluvian, if not reactionary.

There can be little debate about the outcome of the controversy of the 1930s. Within a decade of the publication of *The General Theory,* the intellectual catchword in economics had become "macro." It was truly a remarkable period of intellectual change; the title of Lawrence Klein's brief summary of the era, *The Keynesian Revolution,* is appropriate.[12] Once Samuelson's textbook was published in 1948, the totality of the triumph was assured.[13] It was the prototype of the textbooks that have influenced the economic thinking of untold numbers in the Western world.

Keynesianism Proved or Assumed?

Van der Wee participates in this scenario dutifully as he describes the post-war behavior of the economies of the United States, Canada, Japan, and Western Europe. He begins by asserting (285) that "Keynes's theory was fully confirmed in the Second World War," and later (289) speaks of how the Keynesian "mixed" economy that emerged from the war "lifted itself to a higher plane." At no time does Van der Wee seriously consider the possibility that the Keynesian paradigm might be inappropriate for describing the data with which he grapples.

That is the fundamental shortcoming of his analysis, which almost totally ignores the mounting evidence that the Keynesian framework was flawed from the outset. To begin, serious scholars have been realizing, more and more, that even the factual rationale offered to damn the

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"classical" view represents an erroneous interpretation of the events of the 1930s.[14] Far from the economic failures of that time representing an inherent shortcoming of market adjustment processes, they are powerful evidence of the folly of attempting to interfere with those mechanisms. At the onset of the Great Depression, convinced that the wage-rate adjustments envisaged by the classical view were undesirable, an alliance of political figures and business leaders advocated the underconsumptionist view that, at worst, money wages should be held constant or, better yet, increased. In the process, they turned what should have been a moderately severe economic downturn into the single greatest economic disaster of American history.[15] A formal statistical analysis indicates that money wage rates in 1930 were 7.60 percent higher than they would have been if labor markets had behaved as they did across the interval 1901–1929. And this is after controlling for the impact of the higher tariffs brought on by the Smoot-Hawley legislation. As to unemployment, it rose from 3.2 to 8.7 percent.[16]

Under this interpretation, the economic events of the Depression era demonstrate quite clearly the shortcomings of underconsumptionist notions and the appropriateness of the "classical" view. In a very real sense, the Depression was a controlled experiment. The underconsumptionist way was tried and found wanting. President Hoover effectively prevented wages from falling in order to avoid underconsumption, but to no avail. Yet these events continue to be viewed by many, including Van der Wee, as the definitive evidence of shortcomings in the "classical" paradigm.

How could this be? Intellectual failure, rather than market failure, may be the explanation. Early on, problems emerged with respect to the Keynesian hypotheses. Before the end of the decade of the 1930s, Keynes, in his role as editor of the *Economic Journal,* Britain's leading economics periodical, found himself confronted with evidence that demonstrated that a key empirical proposition he had advanced in *The General Theory* simply did not hold. In *The General Theory,* Keynes accepted the classical idea that employment and real wage rates are negatively related and that reductions in unemployment require declines in real wages. However, he argued against relying on downward movements in money wages as a means of reducing real wages, in fact stating that decreases in money wages will cause real wages to rise and increase unemployment. Now, faced with scholarly articles that challenged this assertion by demonstrating that money and real wages did move together in both the United States and Britain, he accepted them for publication, but penned his own commentary, finessing the controversy by splitting the difference and

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concluding that perhaps there is no relationship between movements in real and money wage rates. This left the basic thrust of *The General Theory* unchallenged: declines in money wage rates still had nothing to contribute to reducing unemployment.[17]

The Post-War Boom

What of the performance of the economy of the United States in the immediate post–World War II period? As the war drew to a conclusion, the consensus of Keynesian "effective demand"–oriented economists was that there would be a return to the relatively high levels of unemployment that marked the 1930s as the stimulus of government expenditures for war purposes was removed. When this did not happen, an *ad hoc* explanation—a "suppressed demand" for consumer goods—was offered to account for the rather smooth adjustment to peacetime conditions.[18] The puzzling aspect of this explanation is that, between 1944 and 1947, personal consumer expenditures rose by only about one-fourth of the decline in "autonomous" expenditures—the sum of government purchases of goods and services, gross private domestic investment, and net exports.

After the expected severe postwar depression that never came, there occurred an era of prosperity that, again, far exceeded Keynesian expectations. Yet after the fact, the post-war prosperity has been widely interpreted as something of a Keynesian *tour de force*. Business cycles following World War II were so mild and brief that the concept of the business cycle began to disappear as a topic of discussion. As Van der Wee puts it, "During the 1960s the solid confidence in the operational growth of the mixed economy led most politicians and economists to judge that the problem of economic crises had been largely solved" (79). Presumably, this realization was based on the experience of the late 1940s and 1950s. It is this era that Van der Wee has in mind when he talks of the "higher plane" that the economies of the West achieved with the advent of the "mixed" economy. And it is this period that is often offered as an example of how well the Keynesian demand management approach to dealing with the business cycle works.[19]

Van der Wee accepts the widely held view that the relative prosperity of the immediate post-war era in the major Western economy, that of the United States, can somehow be interpreted as providing evidence of the efficacy of the Keynesian system. He believes that an "aspect which helped to stabilize the working of the economy was the discretionary use by government of countercyclical measures, inspired by Keynesian

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principles" (76). However, there is no reason to believe that the mildness of business cycles between the end of the war and the 1960s could be attributed to conscious economic policy of a Keynesian stripe. Basically, there are two possible forms such countercyclical policy could take: discretionary fiscal actions of the federal government or monetary policy decisions of the Federal Reserve authorities.

With respect to discretionary fiscal policy, there is no evidence that it was used by the federal government to smooth out aggregate demand variations and mitigate the severity of any of the three business-cycle downturns between 1946 and 1960.[20] In a detailed Brookings Institution study of the post–World War II recessions, Wilfred Lewis, Jr., concluded that "deliberate counterrecession expenditure actions played an insignificant role in the recovery" that followed the 1948–49 recession.[21] Harry Truman's economic advisers, especially Edwin G. Nourse, Chairman of the Council of Economic Advisers, and John W. Snyder, Secretary of the Treasury, were so concerned with the problem of inflation that they welcomed a small recession in order to "cool off" the economy. Lewis's final assessment that "the administration's diagnosis that this was not the long-feared postwar depression—but only a temporary adjustment that would be brief, mild, and self-correcting without drastic federal action—proved to be essentially accurate.[22] "Self-correcting without drastic federal action," however, is a phrase that denies a primary postulate of the Keynesian paradigm. In any case, Keynesian manipulation of aggregate demand through the use of discretionary fiscal policy had nothing to do with the economic recovery that began in late 1949.

The story is much the same regarding the 1953–54 economic slump. To be sure, there was greater concern about the possibility of a recession than in 1949. And Dwight Eisenhower, as the first Republican president since Herbert Hoover, did not wish to preside over a serious recession. However, George Humphrey, Secretary of the Treasury, sounded much like John Snyder. According to Robert Donovan, he felt "a few adjustments were not to be feared—employment could decline for six or seven months without becoming critical.[23] Within the administration, there was discussion of possible public-works projects. From outside, there were cries that disaster was upon us.[24] Still, no concerted set of corrective actions emerged and by mid-summer 1954, it became clear that recovery was occurring. Lewis summarizes this episode as follows: "Discretionary counterrecession expenditure actions were slow to be initiated, were not all announced to the public, and were modest in scope.[25] "Modest in scope" is perhaps something of an exaggeration. Lewis's own calculations reveal that the sum total of "discretionary" fiscal expenditures through

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the third quarter of 1954 was $300 million, less than one-tenth of one percent of Gross National Product for that year.[26] It would be extremely difficult to argue that the economic recovery that began in 1954 represented a triumph of Keynesian demand management.

Recession struck again in July 1957, although recognition of this fact, as usual, was belated. In the early months of 1958 the administration debated how to react. The outside pressures were even greater than in the past. In February, Arthur Burns—who perhaps should have been more understanding, having sat in the White House debates during the previous recession—proclaimed in the *New York Times* that the recession would continue until the government intervened on a large scale.[27] Lewis's summary: the "AFL-CIO charged the administration with seeking to tranquilize the public; the Democratic National Committee attacked Eisenhower's 'Hoover-like approach'; and former President Truman asserted that five years of Republican misrule had brought the country to the brink of depression."[28] A few months later, however, "knowledge that economic recovery was underway became rather general."[29] Lewis's estimates show that discretionary budget expenditures through the quarter in which recovery began totaled $400 million, again less than one-tenth of one percent of Gross National Product.[30]

The other alternative, monetary policy, was equally ineffective in reducing the severity of business cycles. In the early post-war years monetary decisions were subordinated to the Treasury's desire to keep interest rates low to reduce the cost of financing the federal government debt. This was no longer the case after 1951, when an Accord was negotiated between the Treasury and the Federal Reserve that freed the latter to engage in countercyclical monetary policy. The Accord generated optimistic expectations about the future of monetary policy, expectations that were to be unrealized. One assessment states that "the post-Accord decade began with mounting enthusiasm for the general instruments of monetary control—the so-called 'rediscovery of money.' It ended with confidence in a predominantly monetary approach considerably shaken. The desirability of heavy reliance on fiscal methods was increasingly accepted, and sentiment for judicious resort to selective controls appeared to be mounting."[31]

Milton Friedman and Anna Schwartz share this view. In their *A Monetary History of the United States, 1857–1960,* they provide a detailed description of how post-Accord actions of the Federal Reserve system during the 1950s probably exacerbated business cycle swings due to the lag between the initiation of monetary actions and their final effect. They conclude with the following statement: "If this interpretation has any

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validity, it leads to the somewhat paradoxical conclusion that confidence in the efficacy of monetary policy in the 1950s was inversely related to monetary stability. As that confidence has grown, it has produced a growing instability in the stock of money."[32] They then add a wish that would be prophetically unfulfilled: "Hopefully, the process is not explosive but self-limiting."[33]

What generalizations emerge from this experience? Apparently, partly by accident, partly due to executive indecision, the American economy was left to its own devices in responding to the economic instabilities of the immediate post-war era. The result was a series of relatively brief business cycle downturns, each followed by a recovery that would seem to have little relationship to the discretionary actions advocated by Keynes. Rather, the economy showed a systematic self-correcting tendency, contrary to the Keynesian wisdom. Moreover, the self-correcting tendency was manifested through money wage adjustments in the labor market.[34]

In this respect, the immediate post-war era is rather similar to the first three decades of the century. Between 1900 and 1929 there were a number of economic ups and downs that resulted in an average unemployment rate of 4.73 percent. In the later period, 1946–59, the unemployment rate averaged 4.49 percent.[35] Van der Wee seems oblivious to this evidence. Witness his reference to "the impact that post-war employment policies must have had in causing greater cyclical stability during the 1950s and 1960s" (76).

Keynesianism in the 1960s

By the 1960s, the high-water mark of Keynesianism, the range of macroeconomic policy options was almost bewildering. Enter the Phillips Curve, with the suggestion that policy results are limited by a trade-off between unemployment and inflation.[36] As refined by Richard Lipsey and popularized in the United States by Samuelson and Robert Solow, the Phillips Curve was the final element of the Keynesian system.[37] Once it pared down the menu of policy choices, all that remained was purely technical. Let the political system choose the desired mix of unemployment and inflation, and econometric models would provide a set of policy recommendations that would produce that outcome. With the advent of modern high-speed data processing facilities, it would be easy. The Golden Age of Economics, and economists, had arrived.

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The Phillips Curve represented the final renunciation of the classical view of the role of money wage rates in the economy. Now, the relationship was perceived to be one in which the greater the rate of increase in money wage rates (and, by implication, prices), the lower the level of unemployment. Money wage rate adjustments were no longer the central mechanism through which employment levels are determined. Instead, they were seen as a residual effect of the tightening and loosening of labor markets in response to changing levels of aggregate demand.

The decade did not begin in an auspicious fashion. There was another economic downturn, lasting from May 1960 through February 1961. Again, the recovery seemed to have little to do with the use of either discretionary fiscal or monetary policy. Discretionary budget expenditures totalled $800 million, between one- and two-tenths of one percent of Gross National Product.[38] After this episode, there was much more talk of using demand management techniques in manipulating the economy. The thrust, though, shifted away from the business cycle and towards stimulating higher levels of economic growth. This new approach was based on three propositions that emerged in the late 1950s and early 1960s, in addition to the doctrine of the Phillips Curve:

1. The U.S. economy is operating at less than its full potential.
2. Regular government budget deficits may be desirable.
3. A little continuous inflation may not be a bad thing.

These ideas came from the leading lights of the economics profession. Hansen, for one, argued against price stability *per se*; Arthur Okun provided measurements of the gap between potential and actual output in the United States, assuming a four percent unemployment rate; and Samuelson, beyond his collaboration with Solow in popularizing the ruminations of Phillips and Lipsey, declaimed against rigid notions of government budget balancing.[39]

In the light of these ideas, the basic Keynesian paradigm was transformed into the following broad policy prescription: Let us have an excess of government expenditures over revenues, which will generate some degree of price inflation, which will move the economy up the Phillips Curve to a lower unemployment rate, which will increase levels of output and close the gap between potential and actual national income. An addendum to this would be that once the economy reaches its potential level of output it will be possible to keep it on its long-term full employment growth path by the systematic use of discretionary economic policy. In Van der Wee's words, "The application of Keynesian macro-economic

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principles, it was believed, made it possible to 'fine tune' the economy" (79).

After the 1960–61 business cycle downturn, the newly inaugurated Kennedy administration embraced this version of Keynesianism openly. Hansen got his price inflation, Samuelson got his budget deficits, and the American economy marched up its Phillips Curve just as predicted. Since then, however, we have learned that the Phillips Curve relationship exists only as long as the inflation in question is unanticipated. Therein lay the good fortune of those who were formulating economic policy advice in the early 1960s. Inflationary expectations at the beginning of the decade were virtually zero. Thus, the introduction of any price inflation into the system produced declines in unemployment. Even so, the performance of the American economy in the early years of the decade was not particularly outstanding. Influenced by the business cycle downturn of 1960–61, unemployment in 1961 averaged 6.7 percent. It fell to 5.5 percent in 1962 and then edged up to 5.7 percent in 1963. It was not until the inflationary stimulus of the Vietnam War that unemployment rates dipped below four percent. Since labor markets did not anticipate this inflation, it was not reflected in wage demands. Instead, a favorable profit "wedge" was opened up for employers, employment expanded, and the Keynesian paradigm appeared to work.[40] This apparent success may well explain Van der Wee's optimistic view that "through various government measures, a network of economic and social institutions was set up in the West in order to guarantee greater economic stability. This framework saw to it that a slippage in one category of total expenditure would not spread to others; thus total demand would be maintained at a high level" (75–6).

Unfortunately, these were only temporary gains. Eventually, inflationary expectations rose and became incorporated in labor market behavior, causing wage rates to rise more and more rapidly as workers attempted to recover the income they lost to the impact of inflation. As this happened, a profit "squeeze" occurred and unemployment began to increase. The average unemployment rate for 1970 rose to 4.9 percent from 3.5 percent in 1969.[41]

The 5.5 and 5.7 percent rates of price inflation of 1969 and 1970 were, it is easy to forget, perceived as being so disastrous that they led to the imposition of limited wage and price controls, cutting the rate of price inflation to 4.4 percent in 1971. But a series of "inexplicable" shortages of all sorts of goods began to occur, and the unemployment rate rose to 5.9 percent. 1972 saw an inflation rate of 3.2 percent and unemployment of 5.6 percent, and the initiation of a tilt toward stimulating employment. In

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1973, inflation rose to 6.2 percent but unemployment only came down to 4.9 percent. 1974 and 1975 were the catastrophe years. The respective inflation rates were 11.0 and 9.1 percent, with accompanying unemployment rates of 5.6 and 8.5 percent. The neologism "stagflation" hardly captures the human suffering and the debilitating sense of crisis that marked the period—second only to the years of the Depression in this century.

Brave New World

Faced with the humbling experience of the 1970s, Van der Wee recognizes and accepts the demise of the Keynesian paradigm and openly discusses the "failure" of the "mixed" economy. But, still unable to extract himself from its coils, he cannot dismiss it totally, believing, instead, that it is simply no longer appropriate for our time. Changing institutional conditions have rendered the concept of a "mixed" economy obsolete. As he puts it, "The mixed economy . . . came to function within an institutional framework which differed fundamentally from the one originally set up" (320–1).

Such reasoning avoids the difficult task of *explaining* economic change, allowing instead a too easy descent into the practice of choosing our theories to suit some agenda other than the necessary one of attempting to account for phenomena in as orderly and objective manner as possible, given our human limitations. The effect of this pseudo-sophisticated eclecticism is to leave the Keynesian attacks on the market order unquestioned while admitting, in effect, that Keynesianism itself is unsound. The potential contradictions in such a position, which might bother more rigorous minds, are simply ignored.

Van der Wee is eager to transcend both the Keynesian paradigm and the one he assumes Keynesianism made obsolete. Thus, he accepts the Keynesian Revolution just long enough to adopt its undoing of classical economics, not pausing to wonder at the implications of his subsequent abandonment of Keynes. This affords him the latitude to view the "decentralization of economic decision-making down to the level of the individual," allowing for "the planning function [to be] entrusted to the automatic balancing mechanism of the market system" (341), as unacceptable. Thus, he effectively rejects it as a meaningful alternative to the now or soon to be moribund "mixed" economy.

At the same time, he turns away from the notion of highly centralized planning, having observed the current disarray of the economies of

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nations that follow such practices, and feeling that "the centralized planning alternative, seen in the long term, offers little or nothing to countries which wish to continue to function primarily as parliamentary democracies" (341).

What does that leave as an alternative to fit the needs and circumstances of our time? Van der Wee's preferred choice is a variant of decentralized planning that he describes as follows:

> The . . . concept of decentralized planning is that of economic self-management at the company level, accompanied by comparable forms of self-management in the cultural, political and social domains. Together, these make up a system of direct participative democracy. Implicitly it is accepted that the system of self-management involves costs in the area of material welfare, since it does lack economic efficiency. This relative loss is nevertheless argued to be more than proportionately compensated by benefits in the political, cultural and social domains. (342)

Van der Wee is realistic enough to recognize the variety of objections that might be offered to such a system of economic, political and social organization. He offers two full pages of quite tightly packed exposition describing those objections. But in the end, he cannot disavow his vague plan, because

> There is no doubt that in the West the spirit of the age is moving in the direction of economic self-management and decentralized planning. . . . The crucial question is to what degree this trend towards self-management and decentralization can be combined with the existing mixed economy. To the extent that this combination can achieve a new balance between efficiency, distributive justice, and the intellectual and spiritual development of humanity, the perspectives for further development of the mixed economy are favourable and hopeful. If, however, no creative consensus about such a combination can be found, the mixed economy is doomed to fossilization and decline. (344)

Perhaps so. However, there is something ironic in Van der Wee's arguing for the desirability of a watered-down version of economic planning at a time when the tide of world events appears to be moving decisively in just the other direction. And it is doubly ironic that he wishes to build this edifice of decentralized planning on the bones of a Keynesian-style mixed economy that he admits has failed. He is inextricably caught in the web of a past that never was, a past that he extrapolates into a future that cannot be. Other intellectuals have sensed

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that there has been a dramatic change in the course of human events; even Robert Heilbroner openly admits that in the struggle between capitalism and socialism, capitalism has triumphed.[42] But Van der Wee is content to recite the old shibboleths and, in a somewhat disingenuous fashion, to seek back-handed justification for his vision of an orderly world in the history of Keynesian economic policy. This is not intellectual progress.

NOTES

1. An excellent treatment of the emergence of "unorthodox" ideas among professional economists prior to the Great Depression is provided by J. Ronnie Davis, *The New Economists and the Old Economists* (Ames: Iowa State University Press, 1971). See 94–9.
2. Abba P. Lerner, "Mr Keynes' General Theory of Employment, Interest and Money," *International Labor Review* 34 (1936): 437. The editorial introduction states, "It should be added that the article has been read in manuscript by Mr. Keynes himself, who has expressed his approval of it."
3. Underconsumptionist notions have a long history in the literature of economics. See, for example, such works as Thomas Malthus, *Principles of Political Economy* (1820); Sismondi, *Nouveau Principes d'économie Politique* (Paris: Chez Delaunay, 1819); Saint-Simon, *Mémoire sur la Science de l'homme* (1813); Marx, *Das Kapital* (various dates); and John A. Hobson, *The Economics of Unemployment* (London: G. Allen & Unwin, 1922).
4. Of special interest in the 1920s are Hobson; W. T. Foster and W. Catchings, *Profits* (Boston: Houghton Mifflin, 1925); Foster and Catchings, *Business Without A Buyer* (Boston: Houghton Mifflin, 1927); and C. H. Douglas, *Credit-Power and Democracy* (London: C. Palmer, 1920). Another work by Douglas, *Warning Democracy* (London: C. M. Grieve, 1931), also expressed this view.
5. John Maynard Keynes, *The General Theory of Employment, Interest and Money* (London: Macmillan, 1936). Keynes's stature as an economist was based on a number of major works in the post–World War I period, culminating in his *A Treatise on Money* (New York: Harcourt Brace, 1930).
6. Paul A. Samuelson, "The General Theory," in Seymour Harris, ed., *The New Economics* (New York: A. A. Knopf, 1947), 146.
7. *Ibid.*
8. The Neoclassical Alvin Hansen of *Business Cycle Theory* (Boston: Ginn and Co., 1927) gave way to the arch-Keynesian Alvin Hansen of a *Guide to Keynes* (New York: Macmillan, 1953). Haberler had become something of a convert by the time of the fourth edition of his *Prosperity and Depression* (Cambridge, Mass.: Harvard University Press, 1958).
9. W. H. Hutt, *Economists and the Public* (London: J. Cape, 1936).

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10. See Ludwig von Mises, *The Theory of Money and Credit* (New Haven: Yale University Press, 1953), especially 424–5.
11. See F. A. Hayek, *Unemployment and Monetary Policy* (San Francisco: Cato Institute, 1979) and Hutt, *The Keynesian Episode: A Reassessment* (Indianapolis: Liberty Press, 1979).
12. Lawrence R. Klein, *The Keynesian Revolution* (New York: Macmillan, 1947).
13. Paul A. Samuelson, *Economics: An Introductory Analysis,* 1st ed. (New York: McGraw-Hill, 1948).
14. Perhaps the classic argument along these lines is provided in Murray N. Rothbard, *America's Great Depression* (Princeton: Van Nostrand, 1963). Supporting the Rothbard position are Anthony O,Brien, "The Cyclical Sensitivity of Wages," *American Economic Review* (December 1985): 1124–32; Lowell Gallaway and Richard Vedder, "Wages, Prices, and Employment: Von Mises and the 'Progressives,' " *The Review of Austrian Economics* (1987): 33–80; and Morgan O. Reynolds, "Explaining Wage Rigidity, 1929–1931," mimeograph, Texas A&M University, College Station, Texas (January 1988). Earlier, Daniel Creamer, *Behavior of Wage Rates During Business Cycles* (New York: National Bureau of Economic Research, 1950, Occasional Paper 34), reported evidence that is consistent with the Rothbard hypothesis.
15. See Rothbard and Gallaway and Vedder.
16. Herbert Hoover had become enamored of the underconsumptionist notion. At the first hint of a cyclical downturn in late 1929, he convened a series of conferences of business leaders for the purpose of urging them to resist the temptation to cut wage rates. In this instance, presidential rhetoric apparently worked. In our "The Bank Crisis of 1930–1933 and the Labor Market" (presented at the 1984 Cliometrics Society Conference) we provide a formal statistical test showing that wage rates were significantly higher in the post-1929 period than they should have been, based on patterns of wage adjustment over the years 1901–1929. The specifics of the test are as follows: (1) Variations in money wage rates over the years 1901–1929 are explained by movements in levels of prices, labor productivity and tariffs. (2) Based on such an explanation (which accounts for more than 99 percent of the variation in money wage rates), an out-sample prediction is made of the wage rate in 1930. (3) The actual wage rate for 1930 is found to be 7.60 percent greater than the predicted wage rate. Having taken account of the impact of tariff rates on wages, this procedure incorporates any impact that the Smoot-Hawley tariff may have had on labor market conditions. Given that there is no other obvious institutional change in labor markets in 1930 that might explain the divergence between actual and predicted labor market behavior, credence is lent to the proposition that Hoover's efforts to maintain high wage rates did have an effect.
17. The papers in question are John Dunlop, "The Movement of Real and Money Wage Rates," *Economic Journal* (September 1938): 413–34, and Lorie Tarshis, "Changes in Real and Money Wages," *Economic Journal* (March 1939): 150–4.

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Keynes's reply is "Relative Movements of Real Wages and Output," *Economic Journal* (March 1939): 34–51.

18. For a review of the forecasts of government economists, see Michael Sapir, "Review of Economic Forecasts for the Transition Period," *Studies in Income and Wealth,* 11 (New York: National Bureau of Economic Research, 1949): 275–351. Robert A. Gordon, *Business Fluctuations,* 2nd ed. (New York: Harper and Row, 1961), 464, describes the atmosphere at this time as follows: "In the summer of 1945 the belief was fairly widely held in Washington that unemployment would be a serious problem during the winter of 1945–1946." Everett Hagen, using a primitive Keynesian-style econometric model, predicted an unemployment rate of 14.8 percent for the first quarter of 1946 (Sapir, 322). To be sure, it can be argued that a part of the forecasting problem may be traced to a failure to specify the consumption function in terms of "permanent" income rather than current income. However, even this will not account for the magnitude of the disparity between reality and the forecasts of the Keynesian-inspired models.
19. For example, Alvin Hansen, *The American Economy* (New York: McGraw-Hill, 1957), chs. 2 and 3, argues that since 1938 the American economy has been distinctly different than earlier because of the presence of adequate aggregate demand. He summarizes his view by writing that "just as the decade before the Second World War deepened the conviction that the classicals were wrong, so the last fifteen years have strengthened the conviction that Keynes was right with respect to his positive program."
20. Throughout, dating of business cycle downswings is that of the National Bureau of Economic Research.
21. Wilfred Lewis, Jr., *Federal Fiscal Policy in the Postwar Recessions* (Washington, D.C.: The Brookings Institution, 1962), 124.
22. *Ibid.*, 125.
23. Robert J. Donovan, "The Formation of Fiscal Policy: 1953–1954," in Arthur Okun, ed., *The Battle Against Unemployment* (New York: W. W. Norton, 1965): 128.
24. For example, Colin Clark, writing in the Manchester *Guardian,* forecast unemployment rates in the United States in excess of 10 percent unless the government engaged in large spending programs.
25. Lewis, 185.
26. *Ibid.*, 184, Table 24.
27. *The New York Times,* February 16, 1958.
28. Lewis, 206.
29. *Ibid.*, 217.
30. *Ibid.*, 232, Table 28.
31. Charles R. Whittelsey, Arthur M. Freedman, and Edward S. Herman, *Money and Banking: Analysis and Policy* (New York: Macmillan, 1963), 514.
32. Milton Friedman and Anna J. Schwartz, *A Monetary History of the United States, 1867–1960* (Princeton: Princeton University Press, 1963), 638.

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33. *Ibid.*
34. For an exposition of the role of variations in wage rates in explaining changes in unemployment, see Lowell E. Gallaway and Richard K. Vedder, *The "Natural" Rate of Unemployment,* staff study, Subcommittee on Monetary and Fiscal Policy, Joint Economic Committee, Congress of the United States (Washington, D.C.: U.S. Government Printing Office, 1982).
35. All unemployment rates cited are the officially reported ones for the civilian labor force.
36. A. W. Phillips, "The Relation Between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1861–1957," *Economica* (November 1958): 283–99.
37. Richard G. Lipsey, "The Relation Between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1862–1957: A Further Analysis," *Economica* (February 1960): 1–31; Paul A. Samuelson and Robert M. Solow, "Analytical Aspects of Anti-inflationary Policy," *American Economic Review* (May 1960): 177–94.
38. Lewis, 270, Table 30.
39. An example of Hansen's argument is his "The Case for High-Pressure Economics," in Okun, ed., *The Battle Against Unemployment,* 53–60. Okun's contribution is summarized in "The Gap Between Actual and Potential Output," *ibid.*, 13–22. Samuelson advances his argument for persistent budget deficits in the Wicksell Lectures delivered in Sweden in 1961. Pertinent portions of his remarks are reprinted as "Functional Fiscal Policy for the 1960s," in *ibid.*, 103–10.
40. The details of these events are described in Gallaway and Vedder, *The "Natural" Rate of Unemployment.*
41. *Ibid.*
42. Robert L. Heilbroner, "The Triumph of Capitalism," *The New Yorker,* January 23, 1989.

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Richard E. Wagner

POLITICS, CENTRAL BANKING, AND ECONOMIC ORDER

SECRETS OF THE TEMPLE:
HOW THE FEDERAL RESERVE RUNS THE COUNTRY

by William Greider

New York: Simon and Schuster, 1987. 798 pp., $24.95

Greider pursues the theme that the Federal Reserve System promotes the interests of Wall Street—banks and bondholders—over those of Main Street—the rest of society. The wealth of fascinating observations he makes are, unfortunately, organized by a 1950s-style Keynesianism and a faith in unlimited, majoritarian democracy. Neither of these beliefs are at all adequate for remedying the deficiencies of political control of the money supply, which is the real problem Greider has uncovered.

Serialized in *The New Yorker*, prominent on the best seller lists, and the subject of talk shows, *Secrets of the Temple* is clearly a successful book. It is essentially a commentary on American economic and monetary history since the creation of the Federal Reserve System in 1913. While rambling and discursive, *Secrets* tells a simple tale: the Fed has largely acted as an agent of banks and bondholders and has advanced their interests at the expense of those of the remainder of American society.

William Greider is clearly a resourceful and imaginative investigator who has produced a wealth of interesting observations. Observations do not, of course, organize themselves, and Greider's organizing framework has some significant deficiencies. To be sure, Greider lays out no explicit model or vision of political economy. Nonetheless, there is a vision or

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model implicit in *Secrets*, in terms of which its observations and arguments can be rendered coherent, and without which they could not. This model covers both the nature of the economic process and the relationship of politics to that process. Moreover, this model can be used to make intelligible the elements of a reform program that while not pushed strongly in *Secrets* are nonetheless present there—namely, bringing the Fed more directly under political control, as by incorporating the Fed into the Treasury.

Greider's Vision of the Economic Process

Greider's implicit model of the economic process is essentially 1950s-style Keynesianism. In saying this, I should perhaps note that there is a rich interpretative literature, in which some scholars have argued that what is truly central in the economics of Keynes is very different from what is called Keynesian economics.[1] But there is little question as to what Keynesian economics means, even if there is controversy as to its paternity. Most notable is its claim to be able to apprehend the entire economy, substantively and not just formally, in terms of a few simple aggregative relationships or models, as illustrated by the Phillips curve, the income-expenditure model, or the IS-LM apparatus.

The presumption of a stable and exploitable Phillips curve relationship, in which less inflation requires more unemployment, is present throughout *Secrets*.[2] This is evidenced by repeated claims that by pursuing the relatively low rate of inflation its supporters want, the Fed generates increased unemployment among the rest of society. Subsequent experience and scholarship, however, have together destroyed the idea of any stable, exploitable relationship between inflation and unemployment. Inflation and unemployment increased together during the 1970s, in flat contradiction to the Phillips curve framework. It is now recognized that increased inflation can reduce unemployment only to the extent that people do not anticipate the inflation. An unanticipated increase in inflation may initially lead producers to mistake the general increase in demand and prices that inflation represents for an increase in the relative demand for their own products. If so, producers will initially expand output and employment, only to reverse those choices when they subsequently learn that all prices are rising, including those of the inputs they hire. As anticipations come to mesh with reality, the stimulative impact of the inflation will vanish. Indeed, the rational expectations approach to

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monetary theory hypothesizes that the time gap during which inflation might be unanticipated may be very short indeed.[3]

The income-expenditure model that characterizes 1950s-style Keynesianism also endorses the "paradox of thrift" view that can be found in *Secrets*. This paradox suggests that oversaving or underconsumption can threaten prosperity. In this model one person's consumption spending becomes someone else's income. Indeed, there is a multiplier effect by which an increase in consumption spending leads to a multiple increase in income. By contrast, saving is a subtraction from income; indeed, an increase in saving will lead to a multiple reduction in income. There is no recognition that saving does not so much represent a reduction in spending as a means of facilitating increased spending on producer or capital goods.

According to the income-expenditure model, the route to prosperity is through expenditure on consumer goods, which requires the avoidance of excessive saving. One way of doing this is to redistribute income downward, a course Greider applauds several times for its ability to promote prosperity.[4] To the extent that people with lower incomes consume a greater share of their income than people with higher incomes, programs that redistribute wealth downward will promote prosperity, as will programs that discourage saving: "The resumption of inflation would mean rising shares for wage earners and an honest return for commodity producers. Rising prices would restore overburdened debtors to solvency, forgiving them their debts by depreciating money. A return to inflation would begin again to discreetly redistribute wealth in a positive direction" (716).

Greider's Keynesian vision is also apparent in his analytical and normative disjunction between financial and industrial capital (Wall Street and Main Street), as well as in his view that money is essentially a political creation rather than an outgrowth of social trust.[5] As Greider puts it: "Who owned financial capital was the buried fault line of American politics" (37). It is almost as if the economic process were zero sum in nature: "The money question . . . was really an argument about which economic class must suffer, creditors or debtors, and which would benefit, those who derived their incomes primarily from their accumulated financial wealth or those who still earned their livings by 'the sweat of their brow' " (245–6).

Elsewhere, Greider expresses the view that the economic process is hierarchical, with the real economy being subservient to the financial: "The choices made by bankers had profound political consequences: which economic sectors would flourish, which cities and neighborhoods

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and regions of the country would thrive, and which ones would struggle or even perish" (64). Indeed, this view is implicit in the subtitle of *Secrets*, "How the Federal Reserve Runs the Country." As I shall note later, an economy where money is monopolized through a central bank may well be one that shifts the pattern of net returns in favor of financial activity. But there is surely a pervasive complementarity between financial activity and real economic activity, one that may well be exploited more fully under a regime of free banking than under one of central banking.

Greider's Populist Vision of Unlimited Democracy

In the Keynesian framework the economy is seen as being essentially simple; it would seem in principle, then, to be a simple task to use policy to control economic performance.[6] For in the presence of essential simplicity, there are no significant problems of knowledge to impede the use of policy for economic management. The only problem is one of getting the right people into positions of economic management, people who, in Greider's view at least, would pursue a more inflationary policy that would promote the interests of debtors over creditors and of Main Street over Wall Street. For Keynes this would have required management by an elite who would be guided by the "presuppositions of Harvey Road."[7] But for Greider, whose populist sympathies would rebel at such elitism, getting the right people into positions of economic management is something that would result from filling those positions "democratically."[8]

Greider's hostility toward the Fed arises because he thinks the Fed is anti-democratic (e.g. 284–6), not because he is less than completely in favor of central banking *per se*. In various places, Greider suggests that the Fed is driven by an interest in its own survival (67, 390) and by the interests of commercial banks (114, 440), but the predominant interest group he sees as served by the Fed is bondholders, or perhaps even creditors more generally. This interest leads the Fed to choose less inflation and more unemployment than would be desirable for the majority of Americans.

How is it that inflation would operate to the advantage of most Americans? "A social philosopher, searching for a progressive theory of justice, might contemplate the underlying consequences of inflation and conclude that this system was a promising model for social equity. Inflation, after all, discretely redistributed wealth from creditors to debtors, from those who had an excess to those who had none. It took the most from those who had the largest accumulations of wealth but without

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subjecting them to real suffering. They were not impoverished, after all, merely made less wealthy" (44).

In this vein it is notable that at least five times Greider observes that creditors constitute a minority within the population, as 55 percent of the population are net debtors (38, 169, 374, 552, 644). Greider claims this observation illustrates the anti-democratic character of the Fed. Presumably, a referendum would select a higher rate of inflation than the creditor-dominated Fed would allow. Both directly through the Phillips curve relationship and indirectly through a downward redistribution of income, spending and employment would increase under a Fed that promoted the interests of debtors.

For inflation actually to have this effect would require that the terms of credit transactions be independent of what people anticipate future real values to be. Interest would have to be a purely monetary phenomenon, completely controlled by the Fed. This is another version of the belief in a stable Phillips curve. In actuality, of course, the more strongly creditors believe future real values will depreciate, the higher the price borrowers will have to pay to induce creditors to lend. While unanticipated inflation will benefit one side of a credit transaction relative to the other, anticipated inflation will produce no such differential pattern of benefit. But within a 1950s-style Keynesian framework, a Fed whose dominant interests support a less inflationary policy than would result through a referendum would in turn bring about a higher rate of unemployment than would otherwise result. The interests of bondholders, in particular, Greider argues, are advanced at the expense of those who are rendered unemployed by tight monetary policy.

The incorporation of the Fed into the Treasury would, in Greider's judgment, be a move in a democratic direction. So too, one might think, would be the incorporation of the Fed into the Congressional Banking and Currency committees, though Greider does not entertain this possibility. By democracy Greider seems to mean the "will of the majority." Whether such a will can be defined; why it is good to adhere to it; and whether it entails tyrannical elements are issues about which *Secrets* is silent. Neither does *Secrets* seek to reconcile its indictment of the Fed as being anti-democratic with the recognition that the Fed was created by, and is maintained through, the operation of the democratic processes that Greider seems otherwise to extoll.

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Money and the Economic Process

Greider betrays a severe misunderstanding of the nature of economic processes in even speaking of an opposition of interests between debtors and creditors. Granted, there is a sense in which the parties to a contract have opposed interests, in that each would like more favorable terms. Yet the fundamental feature of a contract is that both parties believe they will gain from it; *and a market economy is nothing but a network of contractual relationships*. While borrowers would always be pleased to pay less and lenders would always be happy to receive more, credit relationships are beneficial for both parties. Nor is the significance of there being 45 percent net creditors and 55 percent net debtors as apparent as Greider seems to believe. Most people will occupy both positions over the course of their lives. People typically are net debtors during their early years, and become net creditors during middle age. If such a "life cycle" takes place in a context of population growth, in which younger age cohorts have more members than older age cohorts, there will naturally be more net debtors than net creditors.

But Greider's most fundamental economic misunderstanding stems from his acceptance of the Keynesian vision of the economic process. The economy is viewed metaphorically in Keynesian economics much as a balloon.[9] Just as a balloon that threatens to soar too high can be brought under control by reducing its air pressure, so can an economy threatened by inflation be brought under control by reducing people's ability to spend, as through higher taxes. And just as a sinking balloon can be lifted by increasing its air pressure, so too can a sinking economy be lifted through increased expenditure by government. The economy, like the balloon, is subject to exogenous shocks that expand or contract it. Government acts to offset those shocks.

The formal requirements of stabilization policy are quite simple in the Keynesian framework. But the practice of stabilization policy may be very different (even without raising questions of political incentive). Even if the simple Keynesian story of economic cycles is accepted, it does not follow that government can act consistently to dampen those cycles. For the observed record of economic activity lags behind the choices that produced that record. A decrease in spending for June may not make it into the statistics until August, and yet that decrease may in turn reflect

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choices and decisions that people made in April. Should government then try to compensate for the decrease in June's spending by increasing its spending, still more time must pass before such a program can be implemented. Perhaps not until October, if things move quickly, will government be able to act to offset private spending choices people made in April. Yet by that time people may have decided to increase their spending, so the increased spending by government ends up being compounded by increased private spending. This problem arises because there is no contemporaneous process through which people transmit information of their spending plans to government. All that government has are some statistical observations on the spending choices people made several months earlier.

Even monetarism is, in fact, at one with Keynesianism in the presumption that the economy is simple enough to be apprehended and managed in terms of a few aggregative relationships. The differences between the two schools are due largely to different beliefs about the sources of instability. Monetarists see instability as stemming primarily from the side of money supply, due mainly to actions taken by the central bank. The demand for money is presumed to be quite stable in the aggregate, which suggests that a substantial degree of stability can be achieved if only instability on the monetary supply side could be prevented. A monetary growth rule and thus a relatively inactive central bank is one way of curtailing this instability. Keynesians see instability originating largely on the side of money demand, due to changes in desired spending, particularly on capital goods. A fine-tuning program of variations in the supply of money would make it possible to offset these changes in desired spending (as would an aggressive fiscal policy that stimulated aggregate demand through government spending).

Both of these aggregative approaches, however, fail to recognize that it is possible to have formal knowledge about the structure of economic processes without having substantive knowledge that can be used actively to promote economic stability. An economist can talk about the housing market and the various forces that affect it, using a model of market equilibrium to organize and facilitate thinking, while recognizing all the while that there is nothing in that conceptual construction that makes it possible to bring about or impose that equilibrium independently of the market process itself. It is the existence of a market process that makes it possible to use a model of market equilibrium to describe and understand the situation, it would be impossible to create such an equilibrium independent of the market process..

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The same situation holds as fully for models of monetary equilibrium as it does for other settings. To promote economic stability is to promote equilibrium in the money market. This will result when there is neither an excess demand for nor an excess supply of money at the existing structure of prices. The economic activities of the diverse individuals who constitute the economy will be coordinated. But there is no knowledge available anywhere that makes it possible to impose or create that equilibrium as a policy measure. Rather, what can be said is that the operation of market processes relating to money and credit relationships will tend to result in a pattern of activity that can be characterized by a model of monetary equilibrium.

A monetary authority could no more impose equilibrium on the money market than a housing authority could impose equilibrium on the housing market. Yet a money market organized through an issuance of notes by competing banks, in place of a monopolization of note issue by a central bank, seems far more consistent with the requirements for monetary equilibrium, as George Selgin has explained particularly clearly.[10] Suppose, adopting the Keynesian presuppositions Greider uses, that there is a sudden increase in the demand for money. This would show up at the level of individual banks as a reduction in the rate at which the bank's liabilities enter the clearing process.[11] Excess reserves would result, which the banks could use to expand credit, thereby increasing the supply of money in response to the increased demand and offsetting the deflation that would otherwise result. Should there be a reduced demand for money, the bank's liabilities would enter the clearing process more quickly, leading to an adverse position on excess reserves. This would lead banks to extend new credit less quickly and to be less willing to renew loans when they came due. The supply of money would contract, offsetting the inflation that would otherwise result.

The description of this process of monetary equilibrium is the same as that of a Keynesian model of smoothing out a business cycle, except that it relies upon knowledge that is in the possession of actual participants in the market process, and it uses their profit-seeking incentives to act upon that knowledge. A central banking process does not have such dispersed knowledge available, and must rely instead on aggregative, summary information that is also comparatively stale. And this is to say nothing about the incentives central banks with a monopoly over note issue might have to act in ways contrary to the requirements of monetary equilibrium and economic stability.

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Special Interests and Democratic Pathologies

Greider certainly has a richer view of the operation of self-interest in political processes than does the bulk of the economics profession. Greider would reject unconditionally the standard approach to economic policy throughout the postwar period, which has viewed government, at least potentially, as a benevolent despot, with the economist serving as advisor.[12] Despite Greider's acute awareness of the operation of self-interest in political processes, however, he maintains a roseate view of democratic processes. While he rails against the motives of the Fed, he thinks they would be transformed simply by incorporating the Fed into the Treasury.

There may be good reasons for incorporating the Fed into the Treasury, for instance in order to expose its operations to public scrutiny. But it is exceedingly doubtful that "democracy" is the answer Greider seems to think it is. Even within Greider's normative framework, which equates the good with the will of the majority, the body of public choice scholarship has shown in numerous ways that democratic political processes cannot be said to have any systematic tendency to reflect that will.[13] This scholarship has shown that there is a great degree of arbitrariness in political outcomes, in the sense that what gets approved can be controlled by those who are able to do such things as select the political agenda and control the order of legislative voting.[14] In other words, people with unchanging preferences and values can be led democratically to choose a variety of different, contradictory policy measures. There may, in fact, be no such thing as a "majority will," regardless of the normative status that might be attributed to such a will. And even if such a will should exist, its adoption can be guaranteed only within a system of direct democracy with open access to the agenda. Representative democracy, particularly with single-member constituencies, is exceedingly unlikely to reflect the "majority will," even should it exist, and granting the desirability of its adoption.

An examination of political incentives within democratic systems has revealed a number of dimensions along which those incentives may actually operate to generate instability. Suppose, maintaining Greider's Keynesian vision, that business cycles result from sudden changes in people's desires to spend. Further suppose that processes for the acquisition of knowledge work so quickly that government could act almost contemporaneously to offset the actions of private citizens. Even then, it would not be an easy matter for a government to act only to offset changes in private spending. For governments are biased toward spending. A call

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for government to increase spending would engender relatively weak opposition, because spending programs are important instruments used by politicians to secure political support. But a call to offset increased private spending, say, by running a budget surplus, in order to respond to a lower demand for money, would encounter strong opposition. For to increase taxes without increasing spending would be to impose costs on constituents without the offsetting, visible benefits of government programs. Democratic processes thus can be expected to exhibit a bias toward spending and budget deficits—or toward money-creation and inflation.[15] (Greider's charge that the Fed is insufficiently inflationary these days leads one to wonder why he does not at least applaud the Fed for improving. During the 1950s, prices rose about one percent per year, and the term "creeping inflation" was coined. Three decades later prices are rising about four times as rapidly, and yet the present period has been widely heralded as one of restored price stability.)

Aside from this bias toward spending, democratic governments also possess biases governed by the election cycle. By now a substantial literature has developed on the idea of a political business cycle.[16] The argument here is that governments will to some extent be motivated by electoral considerations to promote economic instability. Expansionary monetary and budgetary policies may be promoted prior to an election, with the resulting negative consequences left to be borne after the election. To be sure, much of this literature is infected with the presumption that the entire economy can be apprehended by the analyst and subjected to relatively precise control by politically motivated policy makers. But this assumption is not necessary in order to ensure the validity of the idea of the political business cycle. In effect, Greider notices part of the phenomenon when he writes about the Fed seeking to accommodate the desires of different administrations.[17] But the literature on the political business cycle correctly attributes such instability not to particular people in authority who might easily be replaced by better people, but to the incentives possessed by anyone in authority in a democracy.

Monetary Order for a Prosperous Commonwealth: Greider II

It is interesting to speculate as to how *Secrets of the Temple* might have looked had the author not been handicapped by his Keynesian orientation and had he been imbued with a more thorough recognition of the force of self-interest in political processes. He certainly would have been much

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harder on the Fed even than he was, but at the same time he would have recognized that the Fed is a creature of those very same democratic processes he otherwise extols so exuberantly. And he would have recognized that it is far easier for government to contribute to economic discoordination than to promote economic coordination. Both the Great Depression of the 1930s and the inflation of the 1970s are attributable to the Fed. Economists have typically referred to these situations as "mistakes." Yet such "mistakes" are unfathomable in terms of a Keynesian model of essential simplicity. Only with a vision that stresses the inherent complexity of the economic process is it possible for such calamities as the Depression and stagflation to be understood as resulting from good intentions being fouled up by unintended consequences.

Moreover, public choice scholars argue that not all government intentions are likely to be deemed good. For instance, there are grounds for suggesting that the onset of the Great Depression may not even have been so much a mistake as a result of deliberate Fed policy.[18] The credit restriction imposed by the Fed in the 1920s had the impact of reducing the number of nonmember banks relative to member banks. The Fed was able to drive out of business many of the banks that would otherwise have been competitive with its member banks. To be sure, profits of member banks also declined for awhile, but then rebounded. However, those member banks that were located in districts with members on the congressional Banking and Currency Committees were affected less negatively than other member banks. It is plausible that the Great Depression emerged in part from an effort by the Fed to accommodate the desires of the members of the Banking and Currency committees to drive competing, nonmember banks out of business. Stories about Arthur Burns trying to gain favor with Jimmy Carter (346) are pretty tame compared with the stories that could be told.[19]

A much more thoroughgoing treatment of self-interest in politics could also have been combined with a vision of the economic process that would have explained why even a benevolent government cannot actively promote economic stability. When the economic process is seen as inherently complex and apprehensible only in terms of some formal features, there is no way that any agency can actively promote economic coordination. Fortunately, market processes ensure that participants will tend to coordinate themselves; the best that government can do is avoid promoting instability and discoordination as a product of the sale of legislative favors. Greider's story, in other words, could have been one of the threats to prosperity from unconstrained or improperly constrained government, and could well have come down as strongly in

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favor of free banking as have a number of recent studies which have not had the benefit of the abundance of factual detail and anecdote in *Secrets of the Temple.*

NOTES

1. See, for instance, Axel Leijonhufvud, *On Keynesian Economics and the Economics of Keynes* (London: Oxford University Press, 1968), and Allan H. Meltzer, *Keynes's Monetary Theory: A Different Interpretation* (Cambridge: Cambridge University Press, 1989). For the argument that on the contrary, Keynesian economics is the economics of Keynes, see Leland B. Yeager, "The Keynesian Diversion," *Western Economic Journal* 11 (June 1973): 150–63.
2. A. W. Phillips, "The Relation between Unemployment and the Rate of Change of Money Wages in the United Kingdom, 1861–1957," *Economica* 25 (November 1958): 283–99. For an influential argument that the Phillips curve can be used as a guide for public policy, see Paul A. Samuelson and Robert M. Solow, "Analytical Aspects of Anti-Inflation Policy," *American Economic Review* 50 (May 1960): 177–94.
3. See, for instance, Robert J. Barro, "Rational Expectations and the Role of Monetary Policy," *Journal of Monetary Economics* 2 (June 1976): 1–32.
4. A second way of protecting against underconsumption is to grant more authority to that most eager spender of all—government. An increase in government spending would act directly to reduce unemployment, as described by the Phillips curve—and there would even be a multiplier effect on income and employment.
5. On these alternative approaches to money, see S. Herbert Frankel, *Two Philosophies of Money: The Conflict of Trust and Authority* (New York: St. Martin's Press, 1977).
6. On this distinction, see F. A. Hayek, "The Theory of Complex Phenomena," in his *Studies in Philosophy, Politics, and Economics* (Chicago: University of Chicago Press, 1967), 22–42.
7. According to Keynes's biographer, Roy Harrod, one of these presuppositions was "the idea that the government of Britain was and could continue to be in the hands of an intellectual aristocracy using the method of persuasion." R. F. Harrod, *The Life of John Maynard Keynes* (London: Macmillan, 1951), 192–3.
8. Populism is discussed explicitly and sympathetically by Greider in ch. 8, "Democratic Money."
9. The importance of metaphor in the development of economic argumentation is set forth in Donald N. McCloskey, *The Rhetoric of Economics* (Madison: University of Wisconsin Press, 1985). The metaphorical treatment of the economy as balloon in Keynesian economics is sketched in Richard E. Wagner, "Economic Manipulation for Political Profit: Macroeconomic Consequences and Constitutional Implications," *Kyklos* 30, no. 3 (1977): 395–410.

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10. George Selgin, The Theory of Free Banking (Totowa, N.J.: Rowman & Littlefield, 1987). For an important historical treatment, see Lawrence H. White, Free Banking in Britain (New York: New York University Press, 1984). For a valuable treatment of central banking from a monetary equilibrium perspective, see Vera C. Smith, The Rationale of Central Banking (London: P. S. King, 1936).
11. On the importance of clearinghouse processes, and a recognition that central banking is not necessary for the provision of such services, see Richard H. Timberlake, "The Central Banking Role of Clearinghouse Associations," *Journal of Money, Credit, and Banking* 16 (February 1984): 1–15.
12. The seminal statement of this position is Jan Tinbergen, *Economic Policy: Principles and Design* (Amsterdam: North Holland, 1956), who developed the theory of economic policy in terms of the selection of objectives and the design of appropriate instruments.
13. See, for instance, William C. Mitchell, "Fiscal Behavior of the Modern Democratic State: Public-Choice Perspectives and Contributions," in *Political Economy: Recent Views*, ed. Larry L. Wade (Boston: Kluwer-Nijhoff, 1983), 69–114. For a comprehensive survey, see Dennis C. Mueller, *Public Choice*, 2nd ed. (Cambridge: Cambridge University Press, 1989).
14. For a small sample of literature, see Thomas Romer and Howard Rosenthal, "Political Resource Allocation, Controlled Agenda, and the Status Quo," *Public Choice* 33, no. 4 (1978): 27–43; Arthur Denzau, Robert Mackay, and Carolyn Weaver, "Spending Limitations, Agenda Control, and Voters' Expectations," *National Tax Journal* 32 (June 1979, Supplement): 189–200; and Charles R. Plott and Michael E. Levine, "A Model of Agenda Influence on Committee Decisions," *American Economic Review* 68 (March 1978): 148–60.
15. James M. Buchanan and Richard E. Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes* (New York: Academic Press, 1977).
16. Much of this is surveyed in Richard E. Wagner, "Boom and Bust: The Political Economy of Economic Disorder," *Journal of Libertarian Studies* 4 (Winter 1980): 1–37; reprinted in *The Theory of Public Choice, II*, ed. James M. Buchanan and Robert D. Tollison (Ann Arbor: University of Michigan Press, 1984), 238–72.
17. For related support, see David I. Meiselman, "Is There a Political Monetary Cycle?," *Cato Journal* 6, no. 2 (Fall 1986): 563–79.
18. Gary M. Anderson, William F. Shughart II, and Robert D. Tollison, "A Public Choice Theory of the Great Contraction," Public Choice 59 (October 1988): 3–23.
19. Greider acknowledges this possibility a bit when, in discussing how the Fed could have acted to stop the Great Depression but did not, and while referring to it essentially as "a failure of human judgment" (300), he observes that "Federal Reserve officers had another reason not to act. . . . Reserve Bank presidents held back because they were anxious to protect the earnings of private commercial banks" (301–2).

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Tyler Cowen

WHY KEYNESIANISM TRIUMPHED OR, COULD SO MANY KEYNESIANS HAVE BEEN WRONG?

Defenders of laissez-faire have not successfully explained the historical experience of the Great Depression. Unemployment was widespread and persistent and cannot be ascribed to government intervention. Legal restrictions offer at best a partial explanation of why real wages did not fall. The Keynesian world view is also supported by experience with investment and equity market volatility, the conversion of Lionel Robbins, the wartime recovery, and the success of postwar macroeconomic performance. Some concluding remarks address how the case for laissez-faire might be revived.

Most critics ascribe the popularity of Keynesian economics to either intellectual error or special interests which favored a larger role for government planning. Without denying the possible importance of these factors, I wish to suggest an alternative hypothesis: the Keynesian vision triumphed because laissez-faire advocates failed to explain the historical experience of the Great Depression.

Keynes is disliked by many because he presented a controversial vision of the world. He saw markets as chaotic and unreliable, requiring systematic and orderly management by an intellectual elite. The nineteenth-century liberal order had passed. The gold standard was a "barbarous relic," and by the end of his career Keynes even questioned the liberal

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shibboleth of free trade. For Keynes, the world had entered an age where no tradition or custom was immune from the scrutiny of reason.[1]

I will not consider whether the Keynesian vision is analytically sound. Many of the other contributors to this issue of CRITICAL REVIEW accept this task and criticize Keynesian theory and policy from a laissez-faire point of view. I agree with many, but not all, of the arguments made in these articles. Rather than address each author on a point-by-point basis, I would like to consider why the Keynesian vision has had so much influence.

Consider the following historical evidence.

Widespread and Persistent Unemployment in the Great Depression

Economic theory implies that involuntary unemployment will be short-lived in a market economy. Most neoclassical, Chicago School, and Austrian economists agree that if workers do not have jobs, wages will fall until employers find it profitable to hire more labor; a well-reasoned statement of this view can be found in John Egger's article in this issue of CR.

Keynes, in contrast, argued that real wage cuts need not restore employment because wage cuts would decrease aggregate demand and prices (and output as well). The fall in nominal wages would not decrease real wages because prices would be lower as well. In extreme cases, attempts to lower wages can lead to a self-aggravating downward spiral. Other versions of Keynesian economics simply assert that real wages are sticky; in either case, however, real wages will not adjust to clear the labor market.[2]

Table 1: U.S. Unemployment and Hourly Wages

	unemployment rate	*real wages in dollars/hour*	*nominal wages in dollars/hour*
1929	3.2	.52	.52
1930	8.9	.54	.52
1931	16.3	.56	.50
1932	24.1	.55	.44
1933	25.2	.58	.44
1934	22.0	.67	.52
1935	20.3	.67	.54
1936	17.0	.68	.55
1937	14.3	.75	.63
1938	19.1	.77	.63
1939	17.2	.78	.63

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The data support the Keynesian view that prolonged unemployment is possible in a market economy and need not produce a fall in real wages. Unemployment and hourly wages (dollars per hour) in America are shown in Table 1.[3] Unemployment remained high throughout the 30s and real wages rose. Similar data can be found for Great Britain, although the British unemployment problem originated in the twenties.[4]

The Great Depression appears to have been characterized by both downward wage stickiness and self-aggravating nominal wage cuts. By the end of 1932, nominal wages had fallen but real wages had not. Egger (and many other critics of Keynes) argues that declines in nominal wages will not be self-aggravating because although wage *rates* fall, the total wage *bill* (and thus aggregate demand) increases because of the new employment stimulated by the wage cuts.

Nominal wage cuts during the Depression, however, did not generally lead to increases in the total wage bill. From 1929 to 1932, for instance, nominal wages fell from 52 cents an hour to 44 cents an hour but the total wage bill declined from $10,898,000,000 to $4,616,000,000.[5] In accord with this result and Keynes's intuition, modern economists have constructed models which show that price and wage flexibility can often be destabilizing.[6]

Failures of the Price System

The laissez-faire interpretation attributes the length and severity of the Great Depression to government intervention which prevented wages and prices from equilibrating markets and eliminating unemployment. However, I have not found evidence of enough government intervention to support this claim.

In their essay in this issue of CR, Gallaway and Vedder present Murray Rothbard's *America's Great Depression*[7] as the classic statement of the laissez-faire case. Although Rothbard presents many sound criticisms of Herbert Hoover's economic policies, scrutiny of his book turns up little convincing evidence of government intervention which can account for the mass unemployment of the Great Depression.

Rothbard cites a number of governmental actions which supposedly prevented real wages from falling. In November 1929 Hoover called a series of White House conferences with major business leaders; at Hoover's urging, these leaders pledged not to cut wages. After this conference, Henry Ford even announced a wage increase.[8] Rothbard also cites Professor Leo Wolman, who claims that business leaders and govern-

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ment were still under the influence of the prevailing doctrine that high and rising wages were good for the economy, and that wages were maintained until the end of 1931. Finally, the Federal government enacted the Davis-Bacon Act, which required the payment of "prevailing wages" on the construction of public buildings.[9]

Rothbard is correct in stating that the nominal wages paid by many firms did not fall until 1931. Nonetheless, Hoover's jawboning does not suffice to explain this fact. If market participants wish to change wages and prices, presidential jawboning matters little. The anti-inflation attempts of Presidents Ford and Carter in the 1970s were laughably ineffective (remember WIN: "Whip Inflation Now"?), even though Ford and Carter had considerably more presidential power at their disposal than Hoover did.

Rothbard cites no evidence that business leaders who did cut wages either suffered governmental penalties or were even threatened with such penalties. Rothbard himself notes that labor union leaders reneged almost immediately on their pledge to Hoover not to try to raise wages.[10] Furthermore, even if Hoover's jawboning influenced the business leaders present at his meetings, it is unlikely that his strictures had much influence on small businessmen. More than 50 percent of manufacturing employees worked for businesses employing fewer than 300 workers.[11] Jawboning is also unlikely to deter the self-employed from lowering the price of their services. If the problem were government intervention, those who were laid off could have found work in these freer sectors.

Although Hoover's rhetoric was probably unwise, market imperfections cannot escape responsibility for the stickiness of nominal wages until late 1931. If Hoover had suggested that all firms dump one-quarter of their output into the ocean, we could not place the entire blame on government if businessmen had complied. The rigidity of nominal wages was certainly aggravated by Hoover, but was more likely the result of misjudgments about the nature of the economic downturn, standards of wage fairness, and differences between the private and social costs of lowering wages.[12]

Nominal wages did eventually fall in the Great Depression, although to little avail. Nominal wages fell from 52 cents an hour in 1929 to 44 cents an hour in 1932.[13] A National Industrial Conference Board investigation in mid-1932 found that of the companies surveyed, 75 percent had imposed wage cuts.[14] Widespread unemployment, however, did not abate. Defenders of the laissez-faire explanation may be correct that wage cuts were not sharp enough, but government interventions are responsible for only a fraction of the problem.[15]

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Nor can government protection of labor unions be blamed for the labor market failures of the Great Depression. The unionized portion of the American labor force did not exceed 8 percent until 1937, and by 1939 was still only 15.8 percent.[16] Likewise, minimum wage laws were not instituted until 1938.

Labor, of course, was not the only unemployed resource in the Great Depression, as capital goods were frequently idle as well. The prices of capital goods, however, did not receive rhetorical support from Hoover. Furthermore, the degree of inflexibility of industrial prices which existed in the Great Depression was not new. The change per month in the wholesale price index induced by a given increase in unemployment was roughly the same in the downturns of 1907–08, 1913–14, and 1929–33.[17]

Many policies of Hoover and Roosevelt encouraged the inefficient use of resources and hindered economic growth. Roosevelt's National Industrial Recovery Act (NIRA), which attempted to regulate wages and prices, was one of the worst of these policies. Yet NIRA cannot account for prolonged rates of high unemployment.

First, the onset and removal of NIRA do not coincide with peaks and troughs of the Depression or unemployment. The initial depression phase reached its trough in March 1933, before NIRA was enacted.[18] The NIRA years (from June 1933 through May 1935) actually saw a partial recovery, until a new setback in 1937. Second, the data on real wages show no additional upward pressure coming in 1933 or ending in 1935, as can be seen in Table 1. Finally, even though NIRA raised nominal wages, it is not clear that it increased real wages, because price supports were implemented as well. The available evidence is sketchy, but it suggests that priority was given to price increases over wage increases.[19]

Stock Market Volatility

Keynes presented a view of capitalism in which investors are ruled by "animal spirits" and markets are captive to "the dark forces of time and ignorance." Economic systems are at the mercy of potentially unstable expectations, which may be triggered at a moment's notice. The stock market crash of 1929, and the subsequent behavior of the stock market and investment, appeared to support the Keynesian view.

After rising steadily through the 1920s, stock prices started to plummet in October 1929. The average stock price in the Dow Jones Industrial Averages (including utilities and transportation) fell from $125.43 in 1929

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to $26.82 in 1932.[20] The initial fall in stock prices is difficult to relate to economic fundamentals, and was caused primarily by panic selling.

Stock prices, in fact, are to this day excessively volatile relative to underlying economic fundamentals. The 508-point drop in the Dow on the modern Black Monday (October 19, 1987), for instance, defies classical theoretical explanation. It is difficult to believe that the expected profitability of large American companies declined by more than 22 percent over a single weekend. Slightly longer time periods demonstrate equally puzzling price movements. In August 1987, the Dow was over 2700, had fallen into the 1700s by October 1987, and returned to the 2700s by October 1989.

More systematic statistical evidence supports the conclusion that stock price movements are linked only loosely to economic fundamentals. Work by Robert Shiller finds that stock prices move nearly twenty times more than expected changes in dividends, although efficient-markets theory predicts that expected dividends determine stock prices.[21] Subsequent research supports Shiller's conclusions (and remedies certain statistical problems in Shiller's original tests).[22]

Not surprisingly, the behavior of equity markets has led many economists to accept the Keynesian view that the demand for investment is unstable as well. A firm's investment demand, of course, is a function of both expectations and the price at which it can raise funds by issuing equity shares.

The Depression era offered support for the Keynesian belief that investment demand is subject to drastic swings. Consider Table 2.[23]

Table 2: Total Gross Private Domestic Investment (in billions of dollars)

1929	16.2
1933	1.4
1934	3.3
1935	6.4
1936	8.5
1937	11.8
1938	6.5
1939	9.3
1940	13.1
1941	17.9

While the bad economic policies of Hoover and Roosevelt may explain low levels of investment, it is not clear that such policies can also account for the investment volatility which was observed.

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Lionel Robbins's Conversion

The earliest and most influential statement of the laissez-faire approach to the Great Depression can be found in Lionel Robbins's *The Great Depression.*[24] Basing his argument upon the Austrian theory of the trade cycle, Robbins ascribes the origins of the Depression to the malinvestments caused by poor monetary policy in the 1920s. The Depression was the inevitable result of the inflationary 1920s, and was worsened by subsequent intervention (such as the Smoot-Hawley tariff). Robbins endorsed laissez-faire as a recovery program.

During the 1930s, however, Robbins converted to Keynesianism and moved away from his belief in laissez-faire. *The Great Depression* stands as a work repudiated by its author.

In his *Autobiography,* Robbins wrote at length on his change of heart:

> Now I still think that there is much in this theory as an explanation of a *possible* generation of boom and crisis. I suspect that there are some episodes in economic history, the railway crisis of 1847 and the American crisis of 1907, for instance, on which it can cast valuable light. . . . But as an explanation of what was going on in the early thirties, I now think it is misleading. Whatever the genetic factors of the pre-1929 boom, their *sequelae,* in the sense of inappropriate investments fostered by wrong expectations, were completely swamped by vast deflationary forces sweeping away all those elements of constancy in the situation which otherwise might have provided a framework for an explanation in my terms. The theory was inadequate to explain the facts.

Robbins also addressed the issue of policy directly:

> Nor was this approach any more adequate as a guide to policy. . . . To treat what subsequently developed in the way which I then thought valid was as unsuitable as denying blankets and stimulants to a drunk who has fallen into an icy pond, on the ground that his original trouble was overheating. I shall always regard this aspect of my dispute with Keynes as the greatest mistake of my professional career, and this book, *The Great Depression,* which I subsequently wrote, partly in justification of this attitude, as something which I would willingly see forgotten. . . . It will always be a matter of deep regret to me that, although I was acting in good faith and with a strong sense of social obligation, I should have so opposed policies which might have mitigated the economic distress of those days.[25]

John Hicks, Nicholas Kaldor, and Abba Lerner are three other economists (of many) who originally subscribed to various Austrian and

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laissez-faire interpretations of the Great Depression. Like Robbins, each later converted to Keynesianism. Robbins, Hicks, Kaldor, and Lerner stand not only among the greatest economists of their generation, but are also renowned for their scholarly and intellectual integrity, qualities which are evident in the passages from Robbins.[26]

The War Brought Recovery

Analysts of the Great Depression, insofar as they voice an opinion, agree unanimously that World War II brought the Depression to an end. While advocates of the laissez-faire view (such as Rothbard) do not endorse this view, they have not provided an alternative explanation concerning the end of the Great Depression. The onset of the war brought significant increases in demand and government spending, and eventually, government control over investment—precisely what Keynes had recommended. The wartime recovery was due also to expansionary monetary policy and the "forced savings" induced by wartime shortages of consumer goods, neither of which can be credited to market forces.[27]

The beginnings of recovery started as early as September 1939 and were spurred by European demand for American exports. Price Administrator Leon Henderson explains the effect of the war on economic recovery:

> The impact [of war in Europe] upon American markets was immediate. Memories of the first World War—memories of insatiable demand, of shortages, of inflation—were rekindled and there was an immediate and sharp increase in buying. The businessman who customarily bought one carload put in an order for three. Prices rose precipitately, basic commodities and basic raw materials both jumping about 25 percent in the single month of September. The rise of prices itself evoked widespread accumulation of inventories that further fed the stream of buying. A speculative boom was on.
>
> Employment in manufacturing increased almost 10 percent by the end of the year. Pay rolls rose 16 percent. The Federal Reserve System index of industrial production, which stood at 106 percent of the 1935–1939 average in August, rose to 125 in December. . . . This was an all-time high. . . .

Economic activity declined again with the onset of the "phony war," which saw a lull in hostilities until April 1940, when Denmark and Norway were invaded.[28] In May 1940 the Low Countries were invaded and shortly thereafter France fell. Both the war and the recovery picked up steam again.

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By the last quarter of 1941, American military expenditures were 16 percent of GNP, whereas total federal expenditures were only 2.5 percent of GNP in 1929. Spending on armaments increased dramatically as the war progressed: from $1.3 billion in 1939 to $6.26 billion in 1941, to a peak of $80.5 billion in 1945. At the same time, recovery proceeded: real GNP rose by 20 percent between 1939 and 1941 and by 70 percent between 1939 and 1945. By 1943, unemployment had fallen under two percent.[29]

The recovery was not limited to sectors producing goods for the war effort. During the war, for instance, total farm output increased by approximately 17 percent.[30] Even though war expenditures did not create real goods and services for consumption, the American people were wealthier in 1945 than they had been in 1939. Prosperity lasted even when the war came to an end. Keynesian economics provided a possible explanation of how an economy could start from a depressed state, spend several years producing economically worthless war outputs, and come out prosperous.

Post-War Stability

Reading scholars in the laissez-faire tradition sometimes produces astonishment that our world of large and active governments manages to survive, much less prosper. Yet, the world economy has experienced remarkable stability and growth in the post-war era. Gallaway and Vedder point out that post-war economic policies have not been unambiguously Keynesian, in the sense of using fiscal policy as a discretionary tool of economic management. Nonetheless, the role of government in macroeconomic planning has increased dramatically across the world. This increase has not prevented postwar economies from compiling a successful track record.

A comparison of the post-war years (1946–1979) with those under the classical gold standard (1879–1913) is instructive.[31] The volatility of the American price level (as measured by standard deviation of price changes in percentage terms), for instance, was actually greater under the gold standard: 5.4 vs. 4.8 percent (although the opposite is true for Great Britain). In addition, the average growth rate of real per capita income is higher in the post-war period: 2.4 vs. 1.4 percent for Great Britain and 2.1 vs. 1.9 percent for America. The volatility of real per capita income is also significantly lower for both countries under the post-war regime.32

These statistics, though far from perfect, do not cast the post-war economic order in a bad light. Many of the economic problems of the

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post-war era were the result of the oil price shocks and the transition to floating exchange rates; eventually, market participants appear to have adjusted to both remarkably well. If the economically successful 1980s were added to the data set, post-war performance would look even better. The classical gold standard, of course, was not based upon laissez-faire. Nonetheless, the data do not support the view that the post-war economic order has performed unacceptably by historical standards.

* * *

I am not a Keynesian. In fact, Randall Kroszner and I are currently writing a book which attempts to present an alternative framework for monetary theory and macroeconomics.[33] Although the book will not discuss policy explicitly, much of the analysis carries a presumption that laissez-faire, chosen as a policy rule, is likely to produce results which are superior to discretionary macroeconomic management.

Kroszner and I argue that laissez-faire would eventually create advanced payments systems which supersede traditional concepts of money. Individuals would hold transaction accounts at mutual funds rather than banks, and equity shares and interest-bearing assets would be used as exchange media. The economy's unit of account would be distinct from the media of exchange; that is, exchange media themselves would be priced. Kroszner and I hope to show that such a system would compensate for the difficulties markets experience in handling deflationary pressures.

But suppose that laissez-faire is impossible, even if it is desirable. Governments may be simply too powerful to be constrained from interfering in macroeconomic affairs. Or perhaps citizens feel that ensuring high levels of employment is the responsibility of the government. In this case, the intellectual competitors of Keynesianism would have to be quite different from the positions espoused by many of the reviewers in this issue of CR.

In the light of history, many have understandably concluded that Keynesian economics was a good thing, given the political constraints which are a modern reality. The Keynesian vision grappled more effectively with the actual experiences of the Great Depression than did previous economic theories. That Keynesianism still survives and sometimes flourishes is the product of neither obvious intellectual error nor of venal statesmen and their lackeys. The task remains to construct a more powerful defense of laissez-faire.

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NOTES

1. For an examination of the development of Keynes's thought, see Allan Meltzer, *Keynes's Monetary Theory* (Cambridge: Cambridge University Press, 1988), and Robert Skidelsky, *John Maynard Keynes* (New York: Viking, 1986).
2. Whether Keynes assumed nominal wage stickiness is a matter of some dispute in the literature. My reading of the *General Theory* is that Keynes presented wage stickiness as a policy recommendation to prevent a downward spiral of wages and prices, but did not use nominal wage stickiness as an assumption. Rigid *real* wages, however, result from either approach.
3. The data on unemployment are taken from Christian Saint-Etienne, *The Great Depression, 1929–1938: Lessons for the 1980s* (Stanford, Calif.: Hoover Institution Press, 1984), 10. The data on real wages are taken from Martin Neil Baily, "The Labor Market in the 1930s," in *Macroeconomics, Prices, and Quantities: Essays in Memory of Arthur M. Okun* (Washington, D.C.: Brookings Institution, 1983), 23. I have divided Baily's data on nominal manufacturing wages by his data on the consumer price index. The basic results do not change if we consider non-manufacturing wages or divide by the wholesale price index.

   The unemployment rates presented here have been challenged by Michael Darby's "Three-and-a-Half Million U.S. Employees Have Been Mislaid: Or, an Explanation of Unemployment, 1934–41," *Journal of Political Economy* 84 (February 1976): 1–16. Darby argues that persons on government work relief should be counted as employed. During the early years of the Depression, however, unemployment was very high but work relief programs were insignificant. Even with Darby's statistics, unemployment for the Depression years averages 14 percent. Furthermore, work relief programs were closer to welfare programs to support those who could not find work, than to jobs that would have otherwise existed in the private sector. See Jonathan Kesselman and N. E. Savin, "Three-and-a-Half Million Workers Were Never Lost," *Economic Inquiry,* April 1978: 205–25.

   Statistical problems with various indices of real wages are considered by Anthony O'Brien, "The Cyclical Sensitivity of Wages," *American Economic Review* 85 (December 1985): 1124–32.
4. See Meltzer, *Keynes's Monetary Theory,* 160. The British economy, however, was more regulated than the American economy. The role of government in America is discussed below.
5. See Broadus Mitchell, *Depression Decade* (White Plains, N.Y.: M.E. Sharpe, 1975), 260.
6. See Brad J. DeLong and Lawrence H. Summers, "Is Increased Price Flexibility Stabilizing?," *American Economic Review* 76 (December 1986): 1031–44.
7. Murray N. Rothbard, *American's Great Depression* (Kansas City: Sheed and Ward, 1975).

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8. *Ibid.*, 188–9.
9. *Ibid.*, 236–7. Rothbard (239) also mentions immigration restrictions as a source of high wages, but such restrictions could not generate domestic unemployment.
10. *Ibid.*, 189.
11. Peter Fearon, *War, Prosperity, and Depression* (Lawrence: University Press of Kansas, 1987), 94.
12. Lowering wages and increasing employment will involve adjustment costs on the part of the firm. Part of the benefits of increased employment spill over onto other firms in the form of increased aggregate demand; firms will not take these external benefits into account when making decisions. See Laurance Ball, N. Gregory Mankiw, and David Romer, "The New Keynesian Economics and the Output-Inflation Tradeoff," *Brookings Papers on Economic Activity* 1 (1988): 1–65.
13. Actual wage cuts may have been much deeper if small firms were more likely to cut wages than large firms, as Rothbard (291–2) suggests. Statistics on wage rates from this era oversampled from large firms (*Historical Statistics of the United States*, vol. I, [Washington, D.C.: Department of Commerce, 1975], 153).
14. Fearon, 138.
15. In addition, sharper wage cuts may have produced a Keynesian downward spiral or aggravated a downward spiral which was already in place, as discussed above.
16. *Historical Statistics*, vol. I, 178, Series D 946–951. Even in Great Britain, unionization covered only 3.7 million workers in 1929; see John Garraty, *The Great Depression* (New York: Harcourt, Brace, and Jovanovich, 1986), 89.
17. See Thomas Mayer, "Comments on 'Monopoly Explanations,' " in *The Great Depression Revisited*, ed. Karl Brunner (The Hague: Kluwer-Nijhoff Publishing, 1981), 211–9, esp. 213.
18. Saint-Etienne, 46.
19. Mitchell, 244.
20. *Ibid.*, 438.
21. Robert J. Shiller, "Do Stock Prices Move Too Much to be Justified by Subsequent Changes in Dividends?," *American Economic Review* 71 (1981): 421–36.
22. N. Gregory Mankiw, David Romer, and Matthew D. Shapiro, "An Unbiased Reexamination of Stock Market Volatility," *Journal of Finance* 40 (July 1985): 677–87, and Kenneth D. West, "Dividend Innovations and Stock Price Volatility," *Econometrica* 56 (January 1988): 37–61.
23. Fearon, 208.
24. Lionel Robbins, *The Great Depression* (New York: Macmillan, 1934).
25. Lionel Robbins, *Autobiography of an Economist* (London: St. Martin's Press, 1971), 154–5.
26. Other economists (generally the older generation), such as Jacob Viner,

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Frank Knight, and Joseph Schumpeter, remained unenamored of Keynes. None of these figures, however, recommended a laissez-faire approach to the Great Depression.

27. Mark Skousen offers an interesting analysis of wartime saving in his "Saving the Depression: A New Look at World War II," *Review of Austrian Economics* 2 (1988): 211–26. Skousen (222), however, does not deny the important role of fiscal policy in igniting the boom. I do not agree with Skousen's implication that Keynesian economics views "forced saving" as contractionary, even though Keynesian economics views normal saving as contractionary.
28. Mitchell, 371.
29. Facts on the war economy are taken from Fearon, 122, 265, 273, 265, 273, and 278.
30. *Ibid.*, 267.
31. The following facts are taken from Anna Schwartz, "Alternative Monetary Regimes: The Gold Standard," in *Alternative Monetary Regimes,* ed. Colin D. Campbell and William R. Dougan (Baltimore: John Hopkins University Press, 1986), 53.
32. Christina D. Romer has shown that nineteenth-century output was considerably less volatile than had previously been believed in her "The Prewar Business Cycle Reconsidered: New Estimates of Gross National Product, 1869–1908," *Journal of Political Economy* 97 (February 1989): 1–37. However, correcting the data as Romer suggests accounts for only two-thirds of the apparently greater instability of the gold standard period.
33. *Explorations in the New Monetary Economics,* co-authored with Randall Kroszner (Basil Blackwell: forthcoming).

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Frank Vorhies

MARX ON MONEY AND CRISES

MARX'S CRISES THEORY:
SCARCITY, LABOR AND FINANCE

by Michael Perelman

New York: Praeger, 1987. 250 pp., $37.95

Perelman shows that Marx assigns a major role to money in bringing about instability under capitalism. The ideology of cheap credit promotes malinvestment and overproduction, which cause the economic crises that will eventually lead to the revolution that will overthrow capitalism. Yet cheap credit serves the interests of capitalists and the state. After a survey of the nineteenth- and twentieth-century literature on Marx's monetary theory, parallels between that theory and the views of Austrian-school economists are pursued.

Marx's monetary theory is profound and generally neglected. Few comprehensive studies of it have been written. It is for the most part not incorporated into the body of mainstream economic theory.

One is almost tempted to say that what characterizes mainstream monetary theory is its *lack* of Marxian insights. Open any textbook on money and banking, and you will be lucky to find even a passing reference to Marx. Try to recall a recent seminar in advanced monetary theory that seriously covered his contributions to the theory of money.

Libraries are filled with books and articles about money, credit, interest, banking, and monetary policy. Considering all that has been written and continues to be written on these subjects without reference to Marx, is his monetary theory important? Perelman's book is the most recent addition to a small body of literature that makes the case that it is.

Marx's early philosophical ideas on money, written in the 1840s, can be found in the *On the Jewish Question* and the *Economic and Philosophic*

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Manuscripts of 1844. His economic analysis of money was developed in the 1850s and 1860s during his research at the library of the British Museum. His ideas on the origins, properties and use of money in the market process are covered in detail in *Grundrisse, A Critique of Political Economy* and the three volumes of *Capital*. Monetary theory played a major part in his writings throughout his career.

Prior to the 1980s, however, only a few papers analyzing Marx's writings on money were published. These include "The Quantity Theory of Money from the Marxist Standpoint" by Hazell (1898), "Marx as a Monetary Theorist" by Morris (1907), "Marx's Theory of Money" by Somerville (1933), and "Karl Marx and Say's Law" by Shoul (1957). The first major book on the subject was Hilferding's *Finance Capitalism*, first published in 1910.

Much more has been written about Marx's theory of economic crises. A classic article on money and crisis is "Mr. Keynes and Marx on the Theory of Capital Accumulation, Money, and Interest" by Fan Hung (1939). Other articles on this subject include Sherman's "Marx and the Business Cycle" (1967), Eagly's "A Macro Model of the Endogenous Business Cycle in Marxist Analysis" (1977), Itoh's "The Formation of Marx's Crisis Theory" (1978), and Kenway's "Marx, Keynes, and the Possibility of Crisis" (1980). One of the classic books on Marx's crisis theory, first published in 1942, is Sweezy's *The Theory of Capitalist Development*. There is also a forgotten M.A. thesis from the University of Colorado that brings Keynes and Hayek into the analysis—Schachter's *The Theory of Crises: Marx, Hayek, Keynes* (1951). Such writings on Marx's crisis theory, however, are generally not based on an analysis and understanding of his monetary theory.

A more recent attempt to connect Marx's crisis theory to his underlying monetary theory is de Brunhoff's *Marx on Money* (1975). This little book gives a thorough—though brief—presentation of Marx's theories of money. It focuses on the first volume of *Capital*, though the third volume has more pertinent material. Other modern published works include Visser's "Marx on Money" (1977), Kuhne's *Economics and Marxism* (1979), and Weeks's *Capital and Exploitation* (1981). The latter is especially worth reading. Weeks progresses from value theory to money to credit to crises.

Foley has written two interesting papers on the subject, "Toward a Marxist Theory of Money" (1975) and "On Marx's Theory of Money" (1983). Lavoie (1979) also has a paper on Marx's money theories. Finally, this reviewer's 1982 doctoral dissertation, *Marx and Mises on Money*, is a comprehensive, comparative study of Marx's monetary theories.

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In light of the paucity of this literature, Perelman's book is a welcome addition. Perelman explains the role of money in Marx's model in bringing about capitalist crises. He also explains other aspects of Marx's model that are not nearly as relevant; the book would have had greater impact had it focused on Marx's monetary theory alone.

There is a chapter on Marx's writings for the New York *Tribune* which Perelman includes to emphasize the interplay between scholarly research and political activism in his writings. Though interesting, it does not directly relate to Marx's writings on money. Other chapters focus on Marx's method, theory of value, and understanding of natural resource scarcity. These chapters add little that is new.

The chapter to read is chapter six, "Fictitious Capital and Crises Theory." In less than fifty pages, Perelman introduces Marx's monetary theory of capitalist crises. For those familiar with the Austrian-school analysis of the business cycle, Marx's theory will appear strikingly similar.

Austrian Business Cycle Theory

The Austrian theory of the business cycle, developed by Mises (1966) and Hayek (1935), focuses on the effect of artificially lowering the market rate of interest. If the interest rate drops below its normal market rate, this signals a shift in individuals' time preference. The low rate signals an increased demand for future consumption and a decreased demand for present consumption. In Keynesian terms, there appears to be a drop in the marginal propensity to consume.

The low rate of interest, in turn, encourages individuals to invest in production for future goods over production of present goods—i.e., to increase the level of investment. Problems arise, however, when the interest rate is artificially forced below its natural level.

An artificially low interest rate signals a change in time preference that has not actually occurred. As people get paid, they attempt to allocate their earnings as in the past—a certain percentage for consumption and the rest for savings. They attempt to buy consumption goods as before, but the economy is now producing investment goods. People supply factories and machinery while demanding bread and chocolate.

The artificially low interest rate distorts the entire structure of the economy. Production (supply) is no longer coordinated with consumption (demand). In response, prices begin to move. The prices of consumer goods, now in relatively short supply, rise. The prices of investment goods, now in surplus, fall. The increase in consumption-goods prices

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brings about inflation. The decline in investment-goods prices brings about bankruptcies.

To prevent the productive sector from crashing, more credit is loaned out. This credit expansion attempts to keep the interest rate below its normal market level. In so doing, it causes further separations of production decisions from consumption desires. It threatens still more inflation and more bankruptcies. If these new threats lead to still further credit expansion, the economy moves towards a crack-up boom. Otherwise, once credit expansion slows, the economy crashes.

According to the Austrians, after artificial interest-rate reductions, the economy not only will crash, it *must* crash to coordinate production with consumption. The rate of interest must readjust to the preferences of individuals for future versus present consumption. The crash is the only cure for a boom that had been brought about by artificially lowering the market rate of interest.

Marx's Business Cycle Theory

Marx differs from the Austrians in the focus of his analysis. The Austrians are concerned with the lowering of the interest rate. They generally see a low rate resulting from a cheap credit policy on the part of the central bank. Marx, on the other hand, focuses on the expansion of credit—the creation of fictitious capital. He sees this arising from the eternal quest by capitalists—specifically money capitalists or bankers—for greater profits.

This difference in perspective is partly due to Marx's peculiar view of the rate of interest. For Marx, unlike the Austrians, interest does not have any coordinating function in a market economy. The interest rate merely reflects the level of bargaining power between money capitalists (bankers) and industrial capitalists (entrepreneurs). The actual rate indicates the division of the surplus value extracted from laborers. In the third volume of *Capital*, Marx explains:

> It is indeed only the separation of capitalists into money-capitalists and industrial-capitalists that transforms a portion of the profit into interest, that generally creates the category of interest; and it is only the competition between these two kinds of capitalists which creates the rate of interest. (Marx 1967, 370)

In observing the economic crises brought about by an artificially lowered interest rate and the corresponding expansion of credit, Marx

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emphasizes the latter. Marx's concept of *fictitious capital* is the same as the Austrians' notion of *artificial credit expansion*. For both Marx and the Austrians, the credit expansion distorts the structure of the economy. In chapter six, Perelman writes:

> Fictitious capital is important because it deflects value relationships from what they might have been if they had been formed in an abstract system resembling perfect competition. In a more concrete situation, these value relations are disturbed by the action of credit, speculation, and restrictive business practices. (171)

Precisely because of the creation of fictitious capital, capitalism tends to overproduce physical capital. In their drive for profits, bankers lend more and more to entrepreneurs. The distortions in the monetary sphere bring about real sector misallocations. Resources are malinvested. Artificial credit expansion creates capitalist crises. Again in the third volume of *Capital*, Marx explains:

> By means of the banking the system the distribution of capital . . . is taken out of the hands of the private capitalists and usurers. But at the same time, banking and credit thus become the most potent means of driving capitalist production beyond its own limits, and one of the most effective vehicles of crises and swindle. (Marx 1987c, 607)
>
> The credit system appears as the main lever of over-production and over-speculation in commerce solely because the reproduction process . . . is here forced to its extreme limits, and is so forced because a large part of the social capital is employed by people who do not own it and who consequently take things quite differently than the owner. . . . This simply demonstrates the fact that self-expansion of capital . . . permits an actual free development only up to a certain point, so that in fact it constitutes an imminent fetter and barrier to production, which are in fact continually broken through by the credit system. (Marx 1967c, 441)

The development and outbreak of economic crises are complex. During the artificial boom, the interest rate is too low and credit expansion is too high. There is overproduction, over-speculation, malinvestment. Overall there is a distortion of relative prices. Prices to not reflect values—whether the nature of these values is objective, as Marx believed, or subjective, as the Austrians contend. Perelman explains:

> The existence of fictitious capital stretches the pricing process even further, permitting prices to deviate from values by a significant margin, allowing for a much more complex, indeterminate structure of deviations. . . . Once

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> the formation of fictitious value breaks the link between prices and values, the pricing system no longer provides the adequate information regarding the real costs of production. . . . For Marx, such fictitious capital allows the link between market values and labor values to become tenuous. (201-3)

Marx himself attacked the idea of a spontaneous coordination of objective values (supply) and market prices (demand) in a capitalist economy. He was strongly critical of Say's celebrated law of the markets. Say's Law states that supply creates its own demand. To demand, one must first supply what others want. Thus in a free market economy, there will never be a general overproduction of goods. Markets will naturally coordinate supply and demand. Marx thought this was nonsense. In the *Economic and Philosophic Manuscripts of 1844*, he wrote:

> The Say-Ricardo School, however, is hypocritical in not admitting that it is precisely whim and caprice which determine production. It forgets the *refined needs*; it forgets there would be no production without consumption; it forgets that as a result of competition production can only become more extensive and luxurious. . . . It wishes to see only *useful* things produced, but it forgets that production of too many useful things produces too large a *useless* population. (Marx 1978, 96)

Unfortunately, Perelman fails to connect Marx's monetary theory of economic crises to his attack on Say's law. Yet there is an important connection—the fact that the greater supply of investment does not increase the demand for future consumption means that Say's law must fail. Credit expansion allows for the relative over-supply of fictitious capital, but the resulting increased investment does not bring about an increased demand for future consumption. Credit expansion distorts the structure of relative prices and causes economic crises. Thus, according to Marx, Say's law does not explain how capitalism actually works:

> The *over-production of commodities* is denied but the *over-production of capital* is admitted. . . . What then does *over-production of capital* mean? Over-production of value destined to produce surplus-value or . . . over-production of commodities destined for reproduction—that is *reproduction on too large a scale*, which is the same as over-production pure and simple.
>
> Defined more closely, this means nothing more than that too much has been produced for the purpose of *enrichment*, or that too great a part of the product is intended not for consumption as revenue, but *for making more money* (for accumulation): not to satisfy the personal needs of its owner, but to give him money, abstract social riches and capital, more power over the labour of others, i.e. to increase this power. (Marx 1978, 533-4)

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Marx is saying here that capital is over-produced because capitalists want to make money for its own sake—rather than satisfying even their own demands for future consumption. They are *not* interested in coordinating supply with demand, so Say was wrong. Overproduction is inherent in capitalism. Production for investment spontaneously exceeds production for consumption. Capitalism is thus doomed to economic crises.

The creation of artificial credit—or fictitious capital—overturns Say's description of capitalism. Credit expansion allows an economy to progress down production paths that are inconsistent with underlying values. In creating artificial credit, the capitalists themselves drive capitalism to recurrent crises. Credit-creation is the Achilles heel of capitalism. In Marx's words:

> Over-production, the credit system, etc., are means by which capitalist production seeks to break through its own barriers to produce over and above its own *limits*. (Marx 1971, 122)
>
> The entire *credit system*, and the over-trading, over-speculation, connected with it, rests on the necessity of expanding and leaping over the barrier to circulation and the sphere of exchange, (Marx 1973, 416)
>
> . . . with the development of the credit system, capitalist production continually strives to overcome the metal [gold] barrier . . . but again and again breaks its back on this barrier. (Marx 1967c, 574)
>
> It is by no means the strong demand for loans . . . which distinguishes the period of depression from that of prosperity. . . . It is precisely the enormous development of the credit system during a prosperity period, hence also the enormous increase in the demand for loan capital and the readiness with which the supply meets it in such periods, which brings about a shortage of credit during a period of depression. (Marx 1967c, 450)

Marx believed the waste and misery of recurring booms and busts would create an ever-growing propertyless class. This proletariat would bring about the violent revolution that would overthrow capitalism and ultimately usher in the epoch of communism. He first articulated this view in the 1840s in *The German Ideology*:

> In the development of productive forces there comes a stage when productive forces and means of intercourse . . . only cause mischief, and are no longer productive but destructive forces (machinery and money); and connected with this a class is called forth, which has to bear all the burdens of society without enjoying its advantages . . . a class which forms the majority of all members of society, and from which emanates the con-

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> sciousness of the necessity of a fundamental revolution, the communist consciousness. (Marx 1969, 94)

Chapter six of Perelman's book is an excellent introduction to the financial underpinnings of capitalist crises and Marx's belief in an inevitable socialist revolution. On the financial causes of capitalist crises, however, Perelman does not carry the analysis as far as Marx did. What allows for the creation of fictitious capital? What allows for the spontaneous expansion of artificial credit? Marx pointed his finger at the Bank of England. Perelman misses this point.

In response to the supposed instability of free banking, governments worldwide have established central reserve banks, such as the Bank of England. Can these reserve banks resolve the financial weakness of capitalism? Marx would have said no. He explained that "it is the developed credit and banking system which creates this oversensitiveness of the whole organism" (Marx 1967c, 572). Referring to the Bank of England, he made it clear that "the central bank is the pivot of the entire credit system" (Marx 1967c, 572).

Government intervenes in banking because capitalists and government bureaucrats want cheap credit. To carry out a cheap credit policy, the money supply must be perpetually expanded. This requires a central bank with a monopoly on the supply of money. Marx wrote extensively, especially in the third volume of *Capital*, about the pivotal role of the Bank of England in English capitalism:

> The largest capital power in London is, of course, the Bank of England which . . . knows enough about the ways and means of feathering its nest, particularly since the Bank Act of 1844. . . .
>
> In so far as the Bank issues notes which are not covered by the bullion reserve in its vaults, it creates symbols of value that constitute for it . . . additional—even if fictitious—capital to the nominal amount of these unbacked notes. And this additional capital yields additional profit. . . .
>
> Is there anything more absurd . . . than the Bank of England . . . —whose notes have credit only thanks to the state—taking payment from the state, i.e., from the public, in the form of interest on government loans, for the power granted it by the state to transform these same notes from paper into money and then to lend it back to the state? (Marx 1967c, 541-51)

Marx argued that central banking brought about the very instability it was supposed to correct. For the Austrians too, central banking is the source of artificial credit creation and the business cycle. They advocate reform of the banking system for capitalism to flourish. For Marx, on the

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other hand, central banking is an *inevitable* part of capitalism. The banking system cannot be reformed. Rather the entire system of money, credit, exchange, wages, prices, interest and profits must be destroyed:

> In this last formulation the problem would have reduced itself to: how to overcome the rise and fall of prices? The way to do this: abolish prices. And how? By doing away with exchange value. But this problem arises: exchange corresponds to the bourgeois organization of society. Hence one last problem: to revolutionize bourgeois society economically. It would then have been self-evident from the outset that the evil of bourgeois society is not to be remedied by *transforming* the banks or by founding a rational *money system*. (Marx 1973, 134)

Marx believed the internal tendencies in capitalism lead to the creation of institutions that render Say's Law meaningless. Central banking is nothing more than an advanced institutional manifestation of the fundamental separation of purchase and sale in an economy based on private property and exchange. Abolishing central banking will not prevent capitalism from developing other means of enriching capitalists and thus bringing about the instability of the economic system. This contrasts with the Austrian view that Say's Law is a natural feature of a market economy and is prevented from operating only by interventionist institutions such as central banking.

Both Marx and the Austrians focus on the monetary factors behind capitalist economic crises, pinpointing the destabilizing effects of artificial credit expansion made possible by central banking. Austrian monetary theory is well known. Perelman's book is a small but welcome step toward exploring the similar though largely unknown monetary theory of Marx.

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Kai Nielsen

A MORAL CASE FOR SOCIALISM

A moral case for socialism is made, eschewing efficiency arguments – as crucial as they are in other contexts. The best feasible models of socialism and capitalism are compared with respect to such fundamental values as well-being, rights, autonomy, equality and justice. It is argued that a feasible democratic socialism is superior in all these dimensions to even the best feasible forms of capitalism.

I.

In North America socialism gets a bad press. It is under criticism for its alleged economic inefficiency and for its moral and human inadequacy. I want here to address the latter issue.[1] Looking at capitalism and socialism, I want to consider, against the grain of our culture, what kind of moral case can be made for socialism.

The first thing to do, given the extensive, and, I would add, inexcusably extensive, confusions about this, is to say what socialism and capitalism are. That done I will then, appealing to a cluster of values which are basic in our culture, concerning which there is a considerable and indeed a reflective consensus, examine how capitalism and socialism fare with respect to these values.[2] Given that people generally, at least in Western societies, would want it to be the case that these values have a stable exemplification in our social lives, it is appropriate to ask the question: which of these social systems is more likely stably to exemplify them? I shall argue, facing the gamut of a careful comparison in the light of these values, that, everything considered, socialism comes out better than capitalism. And this, if right, would give us good reason for believing that

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socialism is preferable—indeed morally preferable—to capitalism if it also turns out to be a feasible socio-economic system.

What, then, are socialism and capitalism? Put most succinctly, capitalism requires the existence of private *productive* property (private ownership of the means of production) while socialism works toward its abolition. What is essential for socialism is public ownership and control of the means of production and public ownership means just what it says: *ownership by the public*. Under capitalism there is a domain of private property rights in the means of production which are not subject to political determination. That is, even where the political domain is a democratic one, they are not subject to determination by the public; only an individual or a set of individuals who own that property can make the final determination of what is to be done with that property.[3] These individuals make that determination and not citizens at large, as under socialism. In fully developed socialism, by contrast, there is, with respect to productive property, no domain which is not subject to political determination by the public, namely by the citizenry at large. Thus, where this public ownership and control is genuine, and not a mask for control by an elite of state bureaucrats, it will mean genuine popular and democratic control over productive property. What socialism is *not* is *state* ownership in the absence of, at the very least, popular sovereignty, i.e., genuine popular control over the state apparatus including any economic functions it might have.

The property that is owned in common under socialism is the means of existence—the productive property in the society. Socialism does not proscribe the ownership of private personal property, such as houses, cars, television sets and the like. It only proscribes the private ownership of the means of production.

The above characterizations catch the minimal core of socialism and capitalism, what used to be called the essence of those concepts.[4] But beyond these core features, it is well, in helping us to make our comparison, to see some other important features which characteristically go with capitalism and socialism. Minimally, capitalism is private ownership of the means of production but it is also, at least characteristically, a social system in which a class of capitalists owns and controls the means of production and hires workers who, owning little or no means of production, sell their labor-power to some capitalist or other for a wage. This means that a capitalist society will be a class society in which there will be two principal classes: capitalists and workers. Socialism by contrast is a social system in which every able-bodied person is, was or will be a worker. These workers commonly own and control the means of produc-

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tion (this is the characteristic form of public ownership).[5] Thus in socialism we have, in a perfectly literal sense, a classless society for there is no division between human beings along class lines.[6]

There are both pure and impure forms of capitalism and socialism.[7] The pure form of capitalism is competitive capitalism, the capitalism that Milton Friedman would tell us is the real capitalism while, he would add, the impure form is monopoly or corporate capitalism. Similarly the pure form of socialism is democratic socialism, with firm workers' control of the means of production and an industrial as well as a political democracy, while the impure form is state bureaucratic socialism.

Now it is a noteworthy fact that, to understate it, actually existing capitalisms and actually existing socialisms tend to be the impure forms. Many partisans of capitalism lament the fact that the actually existing capitalisms overwhelmingly tend to be forms of corporate capitalism where the state massively intervenes in the running of the economy. It is unclear whether anything like a fully competitive capitalism actually exists—perhaps Hong Kong approximates it—and it is also unclear whether many of the actual players in the major capitalist societies (the existing capitalists and their managers) want or even expect that it is possible to have laissez-faire capitalism again (if indeed we ever had it). Some capitalist societies are further down the corporate road than other societies, but they are all forms of corporate, perhaps in some instances even monopoly, capitalism. Competitive capitalism seems to be more of a libertarian dream than a sociological reality or even something desired by many informed and tough-minded members of the capitalist class. Socialism has had a similar fate. Its historical exemplifications tend to be of the impure forms, namely the bureaucratic state socialisms.[8] Yugoslavia is perhaps to socialism what Hong Kong is to capitalism. It is a candidate for what might count as an exemplification, or at least a near approximation, of the pure form.

This paucity of exemplifications of pure forms of either capitalism or socialism raises the question of whether the pure forms are at best unstable social systems and at worse merely utopian ideals. I shall not try directly to settle that issue here. What I shall do instead is to compare *models* with *models*. In asking about the moral case for socialism, I shall compare forms that a not inconsiderable number of the theoretical protagonists of each take to be pure forms but which are still, they believe, historically feasible. But I will also be concerned to ask whether these models—these pure forms—can reasonably be expected to come to have a home. If they are not historically feasible models, then, even if we can make a good theoretical moral case for them, we will have hardly provided a good moral case

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for socialism or capitalism. To avoid bad utopianism we must be talking about forms which could be on the historical agenda. (I plainly here do not take "bad utopianism" to be pleonastic.)

II.

Setting aside for the time being the feasibility question, let us compare the pure forms of capitalism and socialism—that is to say, competitive capitalism and democratic socialism—as to how they stand with respect to sustaining and furthering the values of freedom and autonomy, equality, justice, rights and democracy. My argument shall be that socialism comes out better with respect to those values.

Let us first look at freedom and autonomy. An autonomous person is a person who is able to set her ends for herself and in optimal circumstances is able to pursue those ends. But freedom does not only mean being autonomous; it also means the absence of unjustified political and social interference in the pursuit of one's ends. Some might even say that it is just the absence of interference with one's ends. Still it is self-direction—autonomy—not non-interference which is *intrinsically* desirable. Non-interference is only valuable where it is an aid to our being able to do what we want and where we are sufficiently autonomous to have some control over our wants.

How do capitalism and socialism fare in providing the social conditions which will help or impede the flourishing of autonomy? Which model society would make for the greater flourishing of autonomy? My argument is (a) that democratic socialism makes it possible for more people to be more fully autonomous than would be autonomous under capitalism; and (b) that democratic socialism also interferes less in people's exercise of their autonomy than any form of capitalism. All societies limit liberty by interfering with people doing what they want to do in some ways, but the restrictions are more extensive, deeper and more undermining of autonomy in capitalism than in democratic socialism. Where there is private ownership of productive property, which, remember, is private ownership of the means of life, it cannot help but be the case that a few (the owning and controlling capitalist class) will have, along with the managers beholden to them, except in periods of revolutionary turmoil, a firm control, indeed a domination, over the vast majority of people in the society. The capitalist class with the help of their managers determines whether workers (taken now as individuals) can work, how they work, on what they work, the conditions under which they work and what is done with what they produce (where they are producers) and what use is made of their skills and the like.[9] As we move to welfare state capitalism—

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a compromise still favoring capital which emerged out of long and bitter class struggles – the state places some restrictions on some of these powers of capital. Hours, working conditions and the like are controlled in certain ways. Yet whether workers work and continue to work, how they work and on what, what is done with what they produce, and the rationale for their work are not determined by the workers themselves but by the owners of capital and their managers; this means a very considerable limitation on the autonomy and freedom of workers. Since workers are the great majority, such socio-economic relations place a very considerable limitation on human freedom and indeed on the very most important freedom that people have, namely their being able to live in a self-directed manner, when compared with the industrial democracy of democratic socialism. Under capitalist arrangements it simply cannot fail to be the case that a very large number of people will lose control over a very central set of facets of their lives, namely central aspects of their work and indeed in many instances, over their very chance to be able to work.

Socialism would indeed prohibit capitalist acts between consenting adults; the capitalist class would lose its freedom to buy and sell and to control the labor market. There should be no blinking at the fact that socialist social relations would impose some limitations on freedom, for there is, and indeed can be, no society without norms and some sanctions. In any society you like there will be some things you are at liberty to do and some things that you may not do.[10] However, democratic socialism must bring with it an industrial democracy where workers by various democratic procedures would determine how they are to work, on what they are to work, the hours of their work, under what conditions they are to work (insofar as this is alterable by human effort at all), what they will produce and how much, and what is to be done with what they produce. Since, instead of there being "private ownership of the means of production," there is in a genuinely socialist society "public ownership of the means of production," the means of life are owned by everyone and thus each person has a *right* to work: she has, that is, a right to the means of life. It is no longer the private preserve of an individual owner of capital but it is owned in common by us all. This means that each of us has an equal right to the means of life. Members of the capitalist class would have a few of their liberties restricted, but these are linked with owning and controlling capital and are not the important civil and political liberties that we all rightly cherish. Moreover, the limitation of the capitalist liberties to buy and sell and the like would make for a more extensive liberty for many, many more people.

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One cannot respond to the above by saying that workers are free to leave the working class and become capitalists or at least petty bourgeoisie. They may indeed all in theory, taken *individually*, be free to leave the working class, but if many in fact try to leave the exits will very quickly become blocked.[11] Individuals are only free on the condition that the great mass of people, taken collectively, are not. We could not have capitalism without a working class and the working class is not free within the capitalist system to cease being wage laborers. We cannot all be capitalists. A people's capitalism is nonsense. Though a petty commodity production system (the family farm writ large) is a logical possibility, it is hardly a stable empirical possibility and, what is most important for the present discussion, such a system would not be a capitalist system. Under capitalism, most of us, if we are to find any work at all, will just have to sell (or *perhaps* "rent" is the better word) our labor-power as a commodity. Whether you sell or rent your labor power or, where it is provided, you go on welfare, you will not have much control over areas very crucial to your life. If these are the only feasible alternatives facing the working class, working class autonomy is very limited indeed. But these are the only alternatives under capitalism.

Capitalist acts between consenting adults, if they become sufficiently widespread, lead to severe imbalances in power. These imbalances in power tend to undermine autonomy by creating differentials in wealth and control between workers and capitalists. Such imbalances are the name of the game for capitalism. Even if we (perversely I believe) call a system of petty commodity production capitalism, we still must say that such a socio-economic system is inherently unstable. Certain individuals would win out in this exchanging of commodities and in fairly quick order it would lead to a class system and the imbalances of power—the domination of the many by the few—that I take to be definitive of capitalism. By abolishing capitalist acts between consenting adults, then (but leaving personal property and civil and political liberties untouched), socialism protects more extensive freedoms for more people and in far more important areas of their lives.

III.

So democratic socialism does better regarding the value that epitomizes capitalist pride (*hubris*, would, I think, be a better term), namely autonomy. It also does better, I shall now argue, than capitalism with respect to another of our basic values, namely democracy. Since this is almost a corollary of what I have said about autonomy I can afford to be briefer. In capitalist societies, democracy must simply be *political* democracy.

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There can in the nature of the case be no genuine or thorough workplace democracy. When we enter the sphere of production, capitalists and not workers own, and therefore at least ultimately control, the means of production. While capitalism, as in some workplaces in West Germany and Sweden, sometimes can be pressured into allowing an ameliorative measure of worker control, once ownership rights are given up, we no longer have private productive property but public productive property (and in that way social ownership): capitalism is given up and we have socialism. However, where worker control is restricted to a few firms, we do not yet have socialism. What makes a system socialist or capitalist depends on what happens across the whole society, not just in isolated firms.[12] Moreover, managers can become very important within capitalist firms, but as long as ownership, including the ability to close the place down and liquidate the business, rests in the hands of capitalists we can have no genuine workplace democracy. Socialism, in its pure form, carries with it, in a way capitalism in any form cannot, workplace democracy. (That some of the existing socialisms are anything but pure does not belie this.)[13]

Similarly, whatever may be said of existing socialisms or at least of some existing socialisms, it is not the case that there is anything in the very idea of socialism that militates against political as well as industrial democracy. Socialists are indeed justly suspicious of some of the tricks played by parliamentary democracy in bourgeois countries, aware of its not infrequent hypocrisy and the limitations of its stress on purely legal and formal political rights and liberties. Socialists are also, without at all wishing to throw the baby out with the bath water, rightly suspicious of any simple reliance on majority rule, unsupplemented by other democratic procedures and safeguards.[14] But there is nothing in socialist theory that would set it against political democracy and the protection of political and civil rights; indeed there is much in socialism that favors them, namely its stress on both autonomy and equality.

The fact that political democracy came into being and achieved stability within capitalist societies may prove something about conditions necessary for its coming into being, but it says nothing about capitalism being necessary for sustaining it. In Chile, South Africa and Nazi Germany, indeed, capitalism has flourished without the protection of civil and political rights or anything like a respect for the democratic tradition. There is nothing structural in socialism that would prevent it from continuing those democratic traditions or cherishing those political and civil rights. That something came about under certain conditions does not establish that these conditions are necessary for its continued existence.

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That men initially took an interest in chess does not establish that women cannot quite naturally take an interest in it as well. When capitalist societies with long-flourishing democratic traditions move to socialism there is no reason at all to believe that they will not continue to be democratic. (Where societies previously had no democratic tradition or only a very weak one, matters are more problematic.)

IV.

I now want to turn to a third basic value, equality. In societies across the political spectrum, *moral* equality (the belief that everyone's life matters equally) is an accepted value.[15] Or, to be somewhat cynical about the matter, at least lip service is paid to it. But even this lip service is the compliment that vice pays to virtue. That is to say, such a belief is a deeply held considered conviction in modernized societies, though it has not been at all times and is not today a value held in all societies. This is most evident concerning moral equality.

While this value is genuinely held by the vast majority of people in capitalist societies, it can hardly be an effective or functional working norm where there is such a diminishment of autonomy as we have seen obtains unavoidably in such societies. Self-respect is deeply threatened where so many people lack effective control over their own lives, where there are structures of domination, where there is alienated labor, where great power differentials and differences in wealth make for very different (and often very bleak) life chances. For not inconsiderable numbers, in fact, it is difficult to maintain self-respect under such conditions unless they are actively struggling against the system. And, given present conditions, fighting the system, particularly in societies such as the United States, may well be felt to be a hopeless task. Under such conditions any real equality of opportunity is out of the question. And the circumstances are such, in spite of what is often said about these states, that equality of condition is an even more remote possibility. But without at least some of these things moral equality cannot even be approximated. Indeed, even to speak of it sounds like an obscene joke given the social realities of our lives.

Although under welfare-state capitalism some of the worst inequalities of capitalism are ameliorated, workers still lack effective control over their work, with repercussions in political and public life as well. Differentials of wealth cannot but give rise to differentials in power and control in politics, in the media, in education, in the direction of social life and in what options get seriously debated. The life chances of workers and those not even lucky enough to be workers (whose ranks are growing and will

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continue to grow under capitalism) are impoverished compared to the life chances of members of the capitalist class and its docile professional support stratum.

None of these equality-undermining features would obtain under democratic socialism. Such societies would, for starters, be classless, eliminating the power and control differentials that go with the class system of capitalism. In addition to political democracy, industrial democracy and all the egalitarian and participatory control that goes with that would, in turn, reinforce moral equality. Indeed it would make it possible where before it was impossible. There would be a commitment under democratic socialism to attaining or at least approximating, as far as it is feasible, equality of condition; and this, where approximated, would help make for real equality of opportunity, making equal life chances something less utopian than it must be under capitalism.

In fine, the very things, as we have seen, that make for greater autonomy under socialism than under capitalism, would, in being more equally distributed, make for greater equality of condition, greater equality of opportunity and greater moral equality in a democratic socialist society than in a capitalist one. These values are values commonly shared by both capitalistically inclined people and those who are socialistically inclined. What the former do not see is that in modern industrial societies, democratic socialism can better deliver these goods than even progressive capitalism.

There is, without doubt, legitimate worry about bureaucratic control under socialism.[16] But that is a worry under any historically feasible capitalism as well, and it is anything but clear that state bureaucracies are worse than great corporate bureaucracies. Indeed, if socialist bureaucrats were, as the socialist system requires, really committed to production for needs and to achieving equality of condition, they might, bad as they are, be the lesser of two evils. But in any event democratic socialism is not bureaucratic state socialism, and there is no structural reason to believe that it must—if it arises in a society with skilled workers committed to democracy—give rise to bureaucratic state socialism. There will, inescapably, be some bureaucracy, but in a democratic socialist society it must and indeed will be controlled. This is not merely a matter of optimism about the will of socialists, for there are more mechanisms for democratic control of bureaucracy within a democratic socialism that is both a political and an industrial democracy, than there can be under even the most benign capitalist democracies—democracies which for structural reasons can never be industrial democracies. If, all that notwithstanding,

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bureaucratic creepage is inescapable in modern societies, then that is just as much a problem for capitalism as for socialism.

The underlying rationale for production under capitalism is profit and capital accumulation. Capitalism is indeed a marvelous engine for building up the productive forces (though clearly at the expense of considerations of equality and autonomy). We might look on it, going back to earlier historical times, as something like a forced march to develop the productive forces. But now that the productive forces in advanced capitalist societies are wondrously developed, we are in a position to direct them to far more humane and more equitable uses under a socio-economic system whose rationale for production is to meet human needs (the needs of everyone as far as this is possible). This egalitarian thrust, together with the socialists' commitment to attaining, as far as that is possible, equality of condition, makes it clear that socialism will produce more equality than capitalism.

V.

In talking about autonomy, democracy and equality, we have, in effect, already been talking about justice. A society or set of institutions that does better in these respects than another society will be a more just society than the other society.[17]

Fairness is a less fancy name for justice. If we compare two societies and the first is more democratic than the second; there is more autonomy in the first society than in the second; there are more nearly equal life chances in the first society than in the second and thus greater equality of opportunity; if, without sacrifice of autonomy, there is more equality of condition in the first society than in the second; and if there is more moral equality in the first society than in the second, then we cannot but conclude that the first society is a society with more fairness than the second and, thus, that it is the more just society. But this is exactly how socialism comes out vis-à-vis even the best form of capitalism.[18]

A society which undermines autonomy, heels in democracy (where democracy is not violating rights), makes equality impossible to achieve and violates rights cannot be a just society. If, as I contend, that is what capitalism does, and cannot help doing, then a capitalist society cannot be a just society. Democratic socialism, by contrast, does not need to do any of those things, and we can predict that it would not, for there are no structural imperatives in democratic socialism to do so and there are deep sentiments in that tradition urging us not to do so. I do not for a moment deny that there are similar sentiments for autonomy and democracy in capitalist societies, but the logic of capitalism, the underlying structures

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of capitalist societies—even the best of capitalist societies—frustrate the realization of the states of affairs at which those sympathies aim.[19] A radical democrat with a commitment to human rights, to human autonomy and moral equality and fair equality of opportunity ought to be a democratic socialist and a firm opponent of capitalism—even a capitalism with a human face.

NOTES

1. For arguments about efficiency see David Schweickart, *Capitalism or Worker Control?* (New York: Praeger, 1980) and Samuel Bowles, David M. Gordon and Thomas E. Weisskopf, *Beyond the Wasteland: A Democratic Alternative to Economic Decline* (New York: Anchor Doubleday, 1983).
2. Andrew Levine's work is very important here and my own account has been extensively influenced by his. See Andrew Levine, *Arguing for Socialism* (London: Routledge & Kegan Paul, 1984); Andrew Levine, "On Arguing for Socialism—Theoretical Considerations," *Socialism and Democracy* (Spring/Summer 1968): 19–28; and Andrew Levine, *The Withering Away of the State* (London: Verso, 1987).
3. That this is a system which is distinctive of capitalism and to which there are many working alternatives is shown by A.M. Honoré, "Property, Title and Redistribution" in Virginia Held, ed., *Property, Profits and Economic Justice* (Belmont, Calif.: Wadsworth Publishing, 1980), 84–92.
4. This is carefully argued for by Andrew Levine. See the references in my second note.
5. Kai Nielsen, "Capitalism, Socialism and Justice" in Tom Regan and Donald Van De Veere, eds., *And Justice for All* (Totowa, N.J.: Rowman and Littlefield, 1982), 264–96.
6. G.A. Cohen, "The Structure of Proletarian Unfreedom," *Philosophy and Public Affairs* 12, no. 1 (Winter 1983): 2–33 and John Exdell, "Liberty, Equality and Capitalism," *Canadian Journal of Philosophy* 11, no. 3 (September 1981): 457–72.
7. Nielsen, "Capitalism, Socialism and Justice," 264–69.
8. Ferenc Fehér, Agnes Heller, György Markus, *Dictatorship over Needs: An Analysis of Soviet Societies* (Oxford: Basil Blackwell, 1983).
9. Cohen, "The Structure of Proletarian Unfreedom."
10. G.A. Cohen, "Freedom, Justice and Capitalism," *New Left Review* no. 26 (March/April 1981) and his "Illusions About Private Property and Freedom," *Issues in Marxist Philosophy*, vol. IV, ed. John Mepham and David-Hillel Ruben (Sussex: Harvester Press, 1981), 223–39.
11. G.A. Cohen, *Karl Marx's Theory of History* (Oxford: Clarendon Press, 1978) 73–7.
12. Levine, *Arguing for Socialism*, 1–11.

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13. How far they are from that is shown by Fehér, Heller and Markus, *Dictatorship over Needs*.
14. Claus Offe, *Disorganized Capitalism* (Cambridge, Mass.: MIT Press, 1985), 259–99.
15. Thomas Nagel, *Mortal Questions* (Cambridge: Cambridge University Press, 1979), 106–27.
16. Fehér, Heller and Markus, *Dictatorship over Needs*.
17. John Rawls, *A Theory of Justice* (Cambridge, Mass.: Harvard University Press, 1971); Kai Nielsen, *Equality and Liberty: A Defense of Radical Egalitarianism* (Totowa, N.J.: Rowman and Allanheld, 1985); and Samuel Bowles and Herbert Gintis, *Democracy and Capitalism* (New York: Basic Books, 1986).
18. Levine citations in n 2 above and Nielsen, *Equality and Liberty*.
19. See Richard C. Edwards, Michael Reich and Thomas E. Weisekopf, eds., *The Capitalist System*, 3rd ed. (Englewood Cliffs, N.J.: Prentice-Hall, 1986), and Samuel Bowles and Richard Edwards, *Understanding Capitalism* (New York: Harper and Row, 1985).

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D. F. B. Tucker

ARE RIGHTS MEANINGFUL UNDER SOCIALISM?

THE LEFT AND RIGHTS:
A CONCEPTUAL ANALYSIS OF SOCIALIST RIGHTS

by Tom Campbell

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Campbell's attempt to construct a socialist version of rights and the rule of law fails because it does not draw on individualism. Campbell's positive rights are ineffective barriers to both the schemes of utopian visionaries who command political authority and more mundane sources of the abuse of power. He leaves unanswered the question of who will determine the extent of the "needs" that would constitute socialist rights, in the absence of unlimited resources to fulfill them. And his rejection of individualism leaves him no means of adjudicating among conflicting positive claim-rights.

When liberals talk about enjoying rights they usually mean that various powers are placed in the hands of designated individuals. Thus, a person who enjoys a right to property (say an area of land) may do what he or she decides with it (for example, alienate it by selling or by making a gift of it, cultivating it, building upon it); and if anyone else interferes with the property, the owner may at his or her discretion take legal action, claiming damages. The concept of a right, then, is linked by liberals with the notion that it is somehow important to ensure that persons enjoy a degree of autonomy. Such a commitment to individualism is also reflected in the liberal ideal of the rule of law. For, at a minimum, what the rule of law requires is that a government acts consistently by articulating the rules it intends to enforce and the particular privileges it will recognize. What is important for liberals is that individuals can securely assume that they

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are at liberty so long as there is no law forbidding a contemplated course of action; and that it should also be possible for them to determine what the law is, in all but the hardest cases, and to establish valid claims when they can demonstrate the lawful nature of their demands. Individualism is also reflected in the political morality of liberalism, particularly in the emphasis that is placed on protecting citizens against political authorities. Thus, rights are said to be important because they indicate the limits of legitimate state action over the individual or establish procedural protections so as to ensure that individuals are not subject to arbitrary power and vulnerable to forms of discrimination thought to be the result of prejudice.

Socialist Hostility toward Rights

A problem which socialists often have with such a focus on individual liberties and autonomy is that it seems to negate communal ideals. Moreover, many believe that when personal choice is allowed too wide a scope, egalitarian ideals of social justice may be placed in jeopardy because of the inequalities that inevitably result when people make different choices about how to live their lives. Also, the notion that there are political rights has been linked historically with the rise of the bourgeoisie as a class; and it is accepted by many, especially those influenced by Karl Marx, that anyone who wishes to take rights seriously must also support the establishment of the kind of economic system which allows for private control over capital. Perhaps the most common reason for socialists' hostility towards the concept of a right is simply that it is closely associated with competitive individualism.

Of course, not all socialists are hostile to the ideal of "taking rights seriously." Yet, because of the odium attached to the word "liberal," most of those on the left who espouse some concern for individualist ideals usually refer to themselves as humanists instead. Nevertheless, inasmuch as they think that it will be necessary, even after socialism has been achieved, to protect individuals, respect personal autonomy and dignity, provide procedural safeguards and uphold the rule of law, such writers are distinctively liberal.

Tom Campbell suggests, then, that is possible to identify a distinctively socialist conception of rights. He eschews the usual humanist approach which supposes that socialists have little to learn from liberal theorizing about rights; while, in place of the individualism which characterizes the writing of liberals, he attempts to pioneer a more collectivist, com-

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munalistic conception of rights and the rule of law. Briefly stated, Campbell's ambition is to show that it is coherent to conceive of rights as a set of egalitarian ideals which ought to give rise to few controversies and conflicts in a socialist society; moreover, that their realization need not involve legalistic or adversarial processes but may be more successfully accomplished by sensitive administration. Unfortunately, Campbell's influence will not be constructive, for his attempt at a fresh start is largely misconceived. Indeed, what I wish to demonstrate in this paper is why it is necessary to face up to the problems he avoids and avoid the problems he addresses.

Indulging Utopianism

As I have said, Campbell does not set out to initiate a dialogue with liberal writers; instead, he is interested in contributing to a debate within the left between socialists who he calls Revolutionaries and those he calls Reformists. What strikes him as interesting and worthy of extended commentary is that those he designates as Revolutionary seem to share a conception of rights and law which is essentially similar to that put forward by liberals on the extreme right (Maurice Cranston is mentioned as an example). What characterizes this conception and accounts for why Revolutionaries are so hostile to it, according to Campbell, is that its focus is on negative liberties—the area in which an individual can be sure he or she will not be coerced. In contrast, Reformists, who according to Campbell urge socialists to take rights seriously, employ the concept of a right in a quite different way. Campbell's project is to achieve a reconciliation between the rival socialist camps by exploiting this Reformist approach to rights. Reformists interpret rights as welfare rights and (some) civil liberties (such as free speech and due process of law) as positive liberties. In this way liberties and rights come to entail a concern for the interests of right-holders which requires governments to provide them necessary resources, such as access to the media and legal aid. By exposing this shift in the conception of a right from liberal individualist ideals to a socialist concern for the welfare of individuals, Campbell hopes to endear Reformists, and presumably himself, to the more tough-minded Revolutionaries. In his view, all socialists are concerned to promote the "true interests" of humanity, and once this commitment (rather than bourgeois scruples about legitimate and illegitimate governmental processes) is seen to lie at the heart of a socialist conception of law and

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rights, it may turn out that even Revolutionary Marxists could start using (and claiming for socialism) a discourse which takes rights seriously.

However well-meaning in intent, Campbell's project of reconciliation sets his analysis in an unhelpful direction, for he too willingly indulges Revolutionary fantasies. What he fails to notice is that writers like Cranston emphasize the importance of negative liberties precisely because they think those who enjoy political power cannot be trusted to use it wisely or fairly, and that power can all too easily fall into the hands of fanatics inflamed by dangerous myths (such as the belief that it is possible to accomplish a benign but radical and rapid transformation of social systems). Writers such as Isaiah Berlin, Leszek Kolowkawski, F.A. Hayek and Andrzej Walicki (to name a few) charge Marxist and other allegedly romantic revolutionaries with believing that some non-identifiable proletariat or a surrogate elite leadership could and would use the state to destroy private property and the classes and individuals who own it without being corrupted by their own involvement in such a coercive process; or, what is perhaps even less plausible, with believing that they could accomplish a rapid transformation from capitalism to socialism without making use of an unacceptable degree of terror.

Even leaving this concern aside, Campbell's decision to initiate an internal debate between socialists—rather than a dialogue with liberals which addresses issues relating to the possibility that political power may well be misused—causes him to embark upon what turns out to be a trivial pursuit. The problems begin when he invites us to enter into the fiction of granting

> the socialist critics of rights [that is, the Revolutionary socialists] almost all that they desire by accepting, for the sake of argument, their particular version of what socialist society would be like . . . a relatively extreme and idealistic form of socialism according to which it involves the belief in the possibility and desirability of the successful pursuit of a society characterised by the self-conscious deployment of all human and natural resources, including the communally owned means of production, to satisfy the needs of 'social' man, whose behaviour will be marked by unsullied sociability, developed social responsibility, willing co-operation and the virtual absence of aggression, hostility, competitiveness and the desire to dominate others.(8)

Campbell himself does not endorse these utopian assumptions. He merely asks us to concede them for the sake of argument. But he gives no good reasons why we should do this and no obvious benefit is to be found. Indeed, far from serving to encourage careful reasoning about the

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problems relevant to any discussion of "law" and "rights," if we grant all of the assumptions Campbell lists, we enter into fantasy. The concepts of law and rights which may seem reasonably plausible to rely upon in a socialist utopia have no applicability in the real world.

Campbell thinks he can show that even if we concede the utopian assumptions he lists, it will be desirable to recognize some rights. Even without examining what specific entitlements he has in mind, this is not a startling observation. It must surely be conceded that, even granting good will on the part of participants and agreement about goals, a complex social institution (like a hospital) can only function when specific rights are allocated by articulated rules (such as the rule at the Royal Melbourne Hospital which restricts entry to Casualty Parking to vehicles carrying emergency cases and ambulances). Thus, it is unclear why Campbell finds his claim significant. What would be more interesting is an argument which demonstrates that specific rights protecting the interests of individuals (such as those which come into play in liberal societies when someone is accused of a criminal offense or those which ensure that elections are conducted in a fair and open way) would be essential even in a utopian community.

But Campbell does not show this. All he asks us to accept is that it will be necessary to articulate goals so that political authorities can be reminded of their obligation to provide individuals the wherewithal to satisfy particular socially approved needs. This seems to be the function which the identification of "socialist rights" is to serve in political discourse, according to Campbell's account. Whether the welfare so identified will in fact be provided is, however, a matter Campbell is content to have determined by circumstances, and in this latter regard he is willing to place wide discretion in the hands of various officials. In other words, he leaves to political determination the issue of whether a citizen claimant is to enjoy a right; moreover, because he assumes general benevolence, he does not see any necessity for providing the individuals whose lives are to be affected by administrative decisions with any procedural safeguards—even against mistakes.

It is difficult to see why Campbell indulges utopianism in the way he does. One would suppose that a serious writer seeking to develop some defense of a socialist conception of political rights and law would seek out firmer ground than this. And it is not as though there are no other socialist traditions. Indeed, the strength of much socialist theorizing (of Marxism in particular), far from deriving from the tendency to indulge utopianism, lies precisely in its challenge to liberal complacency about the justice and efficiency of market mechanisms, in its greater sensitivity to the role of

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classes in securing and using political power, and in its analysis of the many ways in which individuals have their capacities circumscribed and sensibilities and values shaped through social circumstances and culture. By indulging utopianism, Campbell draws himself compulsively towards mythical romanticism and forgoes this sociologically oriented approach. This is an unfortunate way to begin a book on so-called socialist rights, for theorists on the left have frequently—and, all too often, justly—been accused of failing to take rights seriously precisely because they have taken utopian romanticism too seriously.

Rights and Our "True Interests"

In developing his socialist conception of rights, Campbell makes use of utilitarian ways of thinking and draws on the work of Neil MacCormick, whom he praises for developing a theory of rights based on the identification of fundamental interests. Campbell suggests that such an orientation should endear itself to socialists who, he argues, are concerned to promote the "true interests" of humanity and must, consequently, be receptive to a "broader form of individualism . . . according to which all members of society ought to have certain of their interests protected and enforced by relatively inviolable and overriding rules" (123).

There are well-known problems with "interest" theories of rights which are worth noting before we proceed to explore Campbell's own account. Briefly stated they are, first, whether and how we can successfully identify the interests or needs which give rise to legitimate rights claims; and second, how the commitment to "individualism" (or, as Campbell puts it, "the broader form of individualism") is to be interpreted. These problems arise within liberalism and it is one reason why "interest" theories are often treated with caution (although one has to allow, in a way that Campbell does not, that the position is well-represented by major writers like John Stuart Mill, Joel Feinberg, D. N. MacCormick, Carl Wellman and David Lyons; even the Kantian, John Rawls, allows for a discussion about needs and interests so long as it takes place under what he calls a "veil of ignorance").

Consider first the link between rights discourse and individualism. Writers such as Mill and Feinberg go to great lengths to avoid what is known as paternalism—the notion that someone in authority should be able to override our own considered judgment about what we find important to us, specifying what our "true" interests are. Thus, Mill's

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justification of his harm principle, although utilitarian in inspiration, makes use of the notion that if we are to realize our capacities as persons we need to make choices for ourselves. In his view, governments act illegitimately when they fail to respect our dignity as persons by refusing to allow us a wide area of autonomy. For Mill, then, whatever our interests turn out to be, their realization will be vitiated, to some extent at least, unless we choose them for ourselves. The individualism involved here is strong. It would not be satisfied by a government which benevolently seeks to meet every need of the individuals whose lives it governs, for it recognizes that our dignity as persons is a fundamental consideration—that the freedom to choose has a priority over the satisfaction of most other needs.

Mill has arguments to support this judgment which rely, ultimately, on assumptions about how we develop a constructive individuality. But I need not go into these here, for my point is simply that liberals who follow Mill (like Feinberg) find it necessary to avoid paternalism by embracing a strong individualism. Indeed, in his essay "The Nature and Value of Rights," Feinberg goes so far as to hold that the concept of a right is itself strongly individualistic. After describing a utopia, Nowheresville, that is similar in many respects to Campbell's socialist community, except that no rights are recognized, he goes on to explore the moral difference which a recognition of rights is likely to make. His summary conclusion is:

> Having rights, of course, makes claiming possible; but it is claiming that gives rights their special moral significance. This feature of rights is connected in a way with the customary rhetoric about what it is to be a human being. Having rights enables us to 'stand up like men', to look others in the eye, and to feel in some fundamental way the equal of anyone. To think of oneself as the holder of rights is not to be unduly but properly proud, to have that minimal self-respect that is necessary to be worthy of love and the esteem of others. Indeed, respect for persons (this is an intriguing idea) may simply be respect for their rights, so that there cannot be one without the other; and what is called 'human dignity' may simply be the recognisable capacity to assert claims. To respect a person then, or to think of him possessed of human dignity, simply is to think of him as a potential maker of claims. Not all of this can be packed into the definition of 'rights'; but these are facts about the possession of rights that argue well their supreme moral importance. More than anything else I am going to say, these facts explain what is wrong with Nowheresville.[1]

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Individual Rights Without Individualism

A reading of the chapter in which Campbell argues that socialists should make use of an "interest" theory of rights indicates that he wishes to jettison the individualism identified as so central by liberals like Mill and Feinberg. According to him, the social commitment to take rights seriously is a commitment to "the equal satisfaction of need at the highest level of fulfillment" (142) and it is clear that, for Campbell, the existence of a right places obligations on those in a position to provide the wherewithal for the satisfaction of the needs of others (143). However, the concept of need here is inherently vague because it is freed from the liberal notion that individuals should have the final word on what their interests are. Also, if we allow that people may have different needs because of their various talents, as we surely must, this leads to very awkward problems. For example, I may need more teaching to reach a level of fulfillment, say the ability to comprehend Shakespeare's *Macbeth*; does this mean (given a "socialist right" to education) that a disproportionate amount of society's educational resources will be directed towards the least able, that is, me? It is clear that Campbell supposes that everyone in a socialist society will be able to reach whatever level of fulfillment they are capable of, so perhaps he would also argue that a talented person will have higher aspirations—not only to enjoy Shakespeare but to read French as well. So, it may also be necessary to direct a more than equal share of educational resources towards the most able. But how are judgments about who is and is not deserving of special treatment to be made?

More significantly, can they be made coherently? Suppose I perform well at school and get into the University of Melbourne's Medical School (now run by the National Health Service) where I eventually qualify as a doctor. Hence, I am capable of helping others gain better health. But suppose, now, that I wish to give up this career because I delight in writing plays. Who is to determine whether my self-appraised need to squander the social resources already devoted to my medical training is one that ought to be satisfied as a matter of right? And will this depend on whether I am as good as Jack Hibberd in persuading others to perform in my plays and read them?

Problems of this kind do not seem to have occurred to Campbell. Perhaps I am misinterpreting his intentions, for he never makes clear how we are to determine the "needs" he wishes to list as rights or how to interpret them when they are listed. Education: how do we allocate places and resources? Fulfilling careers: are these the careers of our choice?

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Effective communication: does this mean others must listen to me or read the views the government publishes on my behalf?

Even supposing that it is reasonable to trust an authority to identify the basic needs which should be realized as a matter of right, further discretion may be required. For example, the need to be healthy or to fulfilling work or to be educated may each qualify to be listed as basic rights, yet it is clear that no society has the capacity to ensure that all of its citizens enjoy an adequate share of these goods. So some decision about how much of society's resources will be devoted to meeting each of these objectives may have to be made, and competing claimants may have to face the fact that the fulfillment of their welfare may need to be traded off against the desirability of meeting the legitimate need of others. Campbell is clearly aware that hard decisions of this kind will often have to be made. However, he fails to note the important distinction, often made by liberals, between circumstances in which a benefit is provided at the discretion of an official—for example, a hospital's admissions officer may not be obliged to admit anyone whose permanent place of residence is more than ten miles from the hospital, unless the case is an emergency—and those circumstances when no discretion is allowed for—for example, the hospital is obliged to admit all local residents who have been prescribed hospital treatment by their doctor. Liberals distinguish these cases by saying that, in the first, the provision of a hospital place would be a good thing, that a humane admissions policy would allow for the officer in charge to use his or her discretion to admit someone who is not a local resident; however, they would argue that reference to a "right" in this context is misleading, for only those who can successfully show that the hospital has no discretion as to whether or not it admits them (for example, the local residents in the second case) may meaningfully claim a right. Thus, in the debate about whether citizens in the United States enjoy welfare rights, what is at issue is whether certain sorts of benefit (such as a level of educational resources) can now be claimed by citizens even when local authorities are reluctant to provide it.

Campbell's claims about the importance of welfare rights would have been more persuasive had he addressed the question of control which has preoccupied liberals. For it is not clear, from what he tells us, whether he believes that it is ever sensible to remove discretion from administrators; and if so, under what circumstances. He clearly does not agree with those liberals who hold that it is usually only meaningful to speak of rights in circumstances when the recipients of welfare enjoy the power to realize or forgo the satisfaction of their important needs.

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Monastic Assumptions

Although Campbell admits that individual initiatives may sometimes be in order, he always treats the circumstances when it would be legitimate for an individual to make claims for himself or herself as exceptional, as when some resource is needed to benefit others. Thus, he tells us that a farmer may claim the use of a tractor if he needs it in order to pursue his duty to work effectively for the common good; such a claim would not be taken badly in a socialist community but recognized as a legitimate demand (145). Even here, however, complex problems which could arise are never analyzed. For example, suppose the tractor claimed by Campbell's farmer was needed by another, X, to build a pool for his children. Let us grant further that until Campbell's farmer had made his claim, X had been allowed the use of it for private purposes by the Tractor Allocation Committee. We may suppose that there was no heavy demand for tractors at the time, and that the Committee failed to anticipate the good social use to which Campbell's farmer could put the tractor. Would this tractor still be available for Campbell's farmer to claim, given that the latter had a more socially beneficial purpose to pursue than the purely private project X had already embarked upon?

Campbell, of course, does not recognize this kind of conflict because his utopian assumptions rule out purely private purposes. He simply supposes that X will collaborate with the farmer in a friendly way—even though the latter wishes to take the tractor X is using to dig his private pool! What is unclear to me, however, is how, in the absence of some conception of private rights (that is, held at the discretion of the persons to whom they have been allocated) it makes sense to suppose that tractors could ever be claimed *by individuals*. Surely, in the hypothesized case, the person to whom the tractor had been allocated, X, is the only one who can claim it. Campbell's farmer has no convincing claim at all even though his proposed project is more worthy than X's purely private concerns. It would seem, then, that in Campbell's utopia, the Allocation Committee always has the final word about who is to enjoy the use of a resource—or, as liberals would put the point, that there are many privileges (for example, to use tractors) but no rights (for the tractors can always be reallocated at the whim of the officials).

At times Campbell writes as though his image of society is of a group of monks enjoying a Christmas feast. There is plenty for all, so everyone's needs are more than catered to. Campbell's community is, however, very much committed to fraternity and all manifestations of individualism are disapproved of. Thus, each monk is to concern himself more with satis-

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fying the needs of others than with his individual claims. For example, monk A may be very hungry or have a pressing need for another glass of wine but he must rely on his fellows to notice this and pass the required resources. Moreover, it is hypothesized that there is no need for adjudication or an adversary system of contestation in such a world (for example, 146); also, Campbell seems to assume that the existence of purely private needs will not necessitate the recognition of "competitive" negative liberties. Of course I exaggerate here; but Campbell comes perilously close to supporting this vision when he makes such claims as that the revolution in motivation which will become manifest in the socialist community

> renders it difficult to visualise a socialist system of rights in operation . . . [for] the purely formal liberties which are analysed as being equivalent to the absence of duties to act or refrain from acting, will assume less significance, since their prime function is to license competition of the sort which will no longer exist under socialism. . . . [Moreover] the social function of the socialist concept of rights would not be centred on courts of law. The chief purpose of societal rules designed to further the concerns of individuals would be within the normal administrative operations of whatever institutional arrangements were thought necessary to organise communal life so as to meet approved human needs. (147)

The overly simple conception of social life which seems to inform so much of Campbell's thoughts about "rights," and especially negative liberties and the role of procedures within legal and political systems, signal that we may be justified in suspecting that he does not fully understand the important social purpose that a successful appeal to a right often serves in liberal systems—that is, the frustration of legitimate collective goals in order to allow for individual autonomy.

Civil Liberties under Socialism

We can explore this conjecture further by briefly reviewing what Campbell has to say about what he takes to be the most fundamental political right, freedom of speech. What I wish to explore is whether he understands that we identify basic rights—entrenching them in bills and manifestos or articulating them as part of a binding political morality—precisely because we distrust political authorities.

A preliminary point worth observing is that the liberal negative liberties which Campbell often treats with such contempt are interpreted positively by him. Thus, the right to travel is not merely a veto power by

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individuals who can insist that a government may not prevent them from crossing a border, but a positive claim to be afforded the necessities which make travel possible: train tickets, Holiday Inn vouchers, or time off from other commitments. And because he argues that the identification of a right signals to authorities that they must provide the wherewithal for the satisfaction of a particular need, he has to allow that many very carefully considered decisions about people's needs will have to be made by somebody in authority whenever anybody seeks to exercise a right.

Campbell applies this positive-rights framework to freedom of speech by embracing Mill's argument in *On Liberty*: "Cynicism about the possibility of impartial consideration of competing opinions in a capitalist society does not destroy the foundation of J. S. Mill's argument that truth emerges from competing ideas. . . . And any restriction on freedom of expression is liable to suppress information relevant to the choices which have to made in the organisation of equal need satisfaction" (158). So far, so good. But what does this commitment mean for Campbell? After all, liberal critics of present-day socialist systems have often made the point that free speech is impossible when a government controls all the processes by means of which ideas are disseminated. If one authority allocates access to all the presses, owns all the radio stations and employs all the journalists, it is not clear how anyone with a dissenting opinion is to get a hearing.

Unfortunately, Campbell fails to answer this hard question; rather, he explains that the bourgeois negative liberties which guarantee autonomy to publishers will be translated (somehow) by socialists into a duty on the part of governmental agencies to provide various resources and supports which will enable the development of a community of participants:

> Speech is not an intrinsically scarce commodity that must be shared around so that what one has another may not have; rather it is an almost indefinitely expandable activity where the fulfillment of one person's interests is not in direct competition with that of another. . . . Regulations to impose some order on the expression of opinions so that one speaks while others listen and each has their turn, rather than being hostile to the goals which justify free speech, in fact contribute to them. . . . [The right] would require very extensive regulation and hence the creation of a complex of power-rights to give reality to the ideal of freedom of expression. Moreover such power-rights would require to be supplemented by positive claim-rights so that the individual would be in a position, as a result of education and material opportunity, to use facilities afforded to him by his claim-rights. (164)

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This statement is, unfortunately, not very well thought out. How is the capacity to inform audiences going to remain a commodity which is not "intrinsically scarce"—and we may add, unequal—if audiences are free to switch off whenever they are bored, free to fail to see the point, or free to seek alternative, more entertaining communications? Also, if speakers are going to be granted autonomy to say what they please and do not have to carry the boring or offensive messages of others—or those they think mistaken or threatening to their chosen target audience—inequalities will arise because particular speakers will collect audiences which find them interesting or reassuring or whatever. Is the regulative agency Campbell envisages going to infringe on editorial autonomy in order to stop this competitive process, in the name of equality of result? For example, if X attracts a mass audience is she going to be required to carry the messages of Y (whose attempt to gather an audience of his own to listen to his important propaganda on behalf of the state was a hopeless flop) in her next program or will Y be able to invite whoever she likes? Suppose that Y refuses; what then? Campbell fails to notice that attempts to impose fairness standards giving people access to media have proved a failure in most instances, for they either violate the autonomy of speakers and editors or they are ineffectual. We can rule that a broadcast company must carry the proceedings of the local parliament, but we cannot legitimately demand that the audience stay tuned. Those who are forced to carry other people's messages simply lose their own right to communicate, because they lose their audience. Yet if we do not impose on the mass media, forcing a sharing of the audience, Campbell's goal of equal participation will not be realized.

Campbell simply fails to address this kind of issue. If he did, he would see that there is more than he credits to liberal views about the importance of the negative liberty to speak, which establishes autonomy as a matter of right.

I have said enough to make clear why Campbell's utopian approach is unlikely to assist our comprehension of why socialists should take rights seriously. Most worrying are his failure to notice that political rights arise out of a well-founded distrust that governmental agencies are likely to ignore the particular interests of individuals; and, related to this, his apparent willingness to abandon the liberal notion, defended so ably by Ronald Dworkin, that rights can best be conceived of as trumps in the hands of individuals who may resort to them when they wish to resist initiatives made by governments which they find threatening. If they can establish the existence of a right—so liberals like Dworkin argue—individuals may legitimately claim the benefits or liberties identified. What

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is most important for these liberals is that those who stand to benefit from a given right ought to be able to ensure its realization for themselves.

I suggest that unless socialist writers acknowledge that liberals are correct to fear for the interests of individuals, unless they cherish some legal protections (that is, rights) against the possibility that political power will be abused—even by democratically accountable authorities—they will fail to develop an adequate theory of law or an acceptable political philosophy. Campbell's attempt to provide an alternative, non-individualist approach simply serves to demonstrate this point.

NOTE

1. Joel Feinberg, "The Nature and Value of Rights," in Feinberg, ed., *Rights, Justice and the Bounds of Liberty: Essays in Social Philosophy* (Princeton: Princeton University Press, 1980), 151.

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Stephen Prince

POLITICS AND THE LINGUISTIC SIGN: VOLOŠINOV'S PHILOSOPHY OF LANGUAGE

MARXISM AND THE PHILOSOPHY OF LANGUAGE

By V.N. Vološinov

translated by Ladislav Matejka & I.R. Titunik

Cambridge, Mass.: Harvard University Press, 1986. 205 pp., $9.95 (paper)

The contributions of Vološinov's theories of language are assessed and are contrasted to traditional Marxist philosophy, Saussurean linguistics and more recent developments in transformational grammar and sociolinguistics. Studying connections between language and politics in the 1920s, Vološinov explored the ways social reality enters verbal signs and their usage, anticipating many of the debates within modern linguistics.

Revolutions have a way of shaking *everything* up. The political institutions of the dethroned regime are examined and reshaped, but so are patterns of human behavior and creativity. The old ways of painting or writing a novel are no longer sufficient. New ways of expressing the revolutionary present must be found, and so, in this way, at a given stage of its development, revolution is a natural friend of the politically committed avant-garde. As the Marxist playwright Bertolt Brecht remarked, reality changes and the means of representing it must also change.

Certainly, all of this was true in the years immediately following the Russian Revolution, when patterns of human life and behavior were passionately rethought. For the Constructivists, the artist became the engineer of a new society. For directors like Sergei Eisenstein, the making of a film was a demonstration of the principles of the Marxian dialectic.

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For the Formalists, the areas of language and literature were re-examined with the aim of discovering scientific units of measurement that would constitute a concrete poetics.

It is within this historical moment, and its often wrenching re-alignments of thought, that the contributions of Valentin Nikolaevich Vološinov to the philosophy of language must be located. Vološinov was a member of Mikhail Bakhtin's sociological circle in the 1920s, which contested with the doctrines of the Formalists to develop a theory of language and literature which would be sensitive to historical and social contexts. Vološinov's precise relation with Bakhtin is a matter of some dispute: was he merely a follower and convenient pen name for Bakhtin himself or an important theorist in his own right? Some accounts suggest that Bakhtin was the source of works appearing under Vološinov's name, while others argue that Vološinov was, indeed, the writer. The latter position will be adopted here, as it has been by Vološinov's translators, Matejka and Titunik. For the purpose of this review, it will be assumed that Vološinov was the author of *Marxism and the Philosophy of Language*. But whoever we may decide was the author, it is important to stress that the ideas in this remarkable, brief work emerged from a complex socio-historical matrix. Both the Formalists and Bakhtin's sociological group were moving toward semiotically oriented accounts of the social role of language. Such an orientation was being collectively, if contentiously, elaborated, and Vološinov provided a decisively politicized formulation of the issues.

The Sign as Superstructure

In *Marxism and the Philosophy of Language*, written in 1929, Vološinov implements an explicitly Marxist approach to the social sciences and recasts traditional linguistic thought in terms of the dialectical materialism the October Revolution had seemed to confirm. Throughout his project, Vološinov is concerned to demonstrate the fundamental relevance for Marxism of the study of language. In this respect, his contribution to Marxist philosophy is of lasting historical and theoretical importance, in ways that will shortly be discussed. For a more general audience, however, he offers a sharply reasoned semiotic analysis of communicative forms, among which language is clearly the most important. He rethinks the problematics of linguistic study – the place and role of language in human society, the appropriate subject matter for linguistic inquiry and the boundaries of the field, and the proper method for approaching the

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subject. As he develops his arguments, he does battle with influential schools of linguistic thought, particularly with that of the Swiss linguist Ferdinand de Saussure, whose influence on Vološinov's contemporaries was great. His analysis anticipates, and lays a foundation for, the contemporary formulations of sociolinguistics.

Vološinov divides his book into three parts. In the first, he discusses the importance of an adequate understanding of language for Marxism and, indeed, the centrality which such an understanding must occupy in the Marxist framework. This section is the most generally theoretical. In the second part of the book, Vološinov maps out contours of a Marxist investigation of language—including verbal interaction, the generation of language, and meaning. The final section of the book represents an application of the theories derived from the previous sections. Here, Vološinov presents an analysis of reported speech, that is, of speech which quotes or paraphrases the utterances of another person. Reported speech is a kind of meta-speech, speech about speech, and Vološinov explores the syntactic rules and conventions that operate in reported speech, arguing that these rules are socially and historically bound in particular ways in different languages. By studying these rules, Vološinov maintains that we gain insight into processes central to the use of human language—processes of citation and paraphrase—and, more broadly, into social conventions for representing the consciousness of others (as revealed through speech).

In mapping out, and arguing for, the central relevance for Marxism of an adequate understanding of language, Vološinov conceived of his book as a pioneering contribution, which indeed it was. He begins by calling the reader's attention to a lacuna within Marxist thought: "To date, there is not as yet a single Marxist work on the philosophy of language" (xiii). This neglect was part of a larger, historically bound indifference within classical Marxism to matters pertaining to the "superstructure," which were regarded as epiphenomenal and, therefore, less analytically central than issues pertaining to the economic "base." In order to see how Vološinov's work broke new ground for Marxist thought, we should briefly consider deficiencies in the traditional framing of the base-superstructure issue.

The classic conceptualization for traditional Marxism of superstructural issues—i.e., issues in the province of ideology—occurs in *The German Ideology*, where Marx formulates the notion of ideology as an upside-down illusion, distorting the "real" basis and relations of society in terms of the interest of the dominant class. (This formulation contains a problematic that all subsequent discussion of ideology has inherited and

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had to grapple with: that of defining and justifying the place "outside" ideology from which the analyst speaks.) In a famous passage, Marx writes that:

> The sum total of these relations of production constitutes the economic structure of society, the real foundation, on which rises a legal and political superstructure and to which correspond definite forms of social consciousness. The mode of production of material life conditions the social, political and intellectual life process in general. It is not the consciousness of men that determines their being, but, on the contrary, their social being that determines their consciousness.[1]

This is a perfectly adequate *initial* formulation of the problem, but it would prove to be a hindrance to later Marxist thinkers because of what it omits: the precise nature of the mediation between base and superstructure. Since a reflectionist theory will not do, it is important to specify how concrete economic relations link up with the more abstract areas of consciousness and ideas. What is the precise nature of the mediation?

Subsequent Marxist philosophers struggled to find the link, and its absence was often responsible for the collapse of their systems. Lukács, for example, displaced notions of the exclusive importance of the economic base by offering an analysis of "reification" and of class consciousness, but he ended by dissolving dialectics altogether, and history, by making the proletariat the perfect subject-object of the materialist process. Similarly, the critical theory of the Frankfurt School suffered from an inadequate account of the place of ideology within social process. Without such a basis, critical theory fell into constructions of the one-dimensional world of state capitalism, where the culture industry homogenized the consciousness of the masses.

Deconstructing Consciousness

Working in the late 1920s, Vološinov was well aware of the shortcomings of Marxist thought in this area. He wrote, "As far as questions connected with the material of ideological creativity and the conditions of ideological communication are concerned, those questions, as secondary matters for the overall theory of historical materialism, did not receive concrete or conclusive resolution" (xiii). Vološinov set out to rectify this situation by removing ideology from the abstract sphere of "consciousness" where

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Marx had placed it and setting it in the material world as an objective, concrete phenomenon.

He accomplishes this through an analysis of the sign that places him well within the dominant current of twentieth-century thought, which stresses issues of code and convention in human cognition and activity. The sign functions for Vološinov as the commodity did for Marx, as his basic unit of measurement. In *Capital*, Marx moved from the microscopic to the macroscopic, from analysis of commodities to analysis of the capitalist economic system. Similarly, Vološinov begins with an analysis of the sign and discusses the way in which its circulation illuminates issues of the role and place of consciousness, of the social construction of the self, and of the relations between base and superstructure.

Ideology, he argues, is not a matter of spirit or psychology, of consciousness, but, rather, of signs. It is a semiotic phenomenon: "The domain of ideology coincides with the domain of signs. They equate with one another. Wherever a sign is present, ideology is present, too. Everything ideological possesses semiotic value" (10). In this way, Vološinov is able to locate ideology *in* the world, not as a set of abstract ideas, but as possessing a material embodiment in the form of space, sound, color, body movement. Ideology is not found inside the consciousness of individuals but is found "outside," in the social territory between members of a culture. Signs are not the expression of a personality; they are not formed by consciousness. "The individual consciousness not only cannot be used to explain anything, but, on the contrary, is itself in need of explanation from the vantage point of the social, ideological medium" (12). Notions that signs are the expression of individuals communicating messages are inverted by Vološinov. Consciousness is de-constructed and is seen as occurring only within the material of signs:

> Outside objectification, outside embodiment in some particular material (the material of gesture, inner word, outcry), consciousness is a fiction. It is an improper ideological construct created by way of abstraction from the concrete facts of social expression. But consciousness as organized, material expression (in the ideological material of word, a sign, drawing, colors, musical sound, etc.)—consciousness, so conceived, is an objective fact and a tremendous social force. (90)

By removing signs from the arena of consciousness, they may be regarded in their true dimension: the province of the social. For Vološinov, signs can only arise within a culturally structured space among individuals who are organized socially. Such signs are charged

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with social shape and meaning: "The reality of ideological phenomena is the objective reality of social signs. The laws of this reality are the laws of semiotic communication and are directly determined by the total aggregate of social and economic laws" (13).

By locating ideology in the circulation of signs, Vološinov is able to demonstrate the relevance of language for Marxist thought. Language provides a key link between base and superstructure. The problem of base and superstructure, he writes, "comes down to *how* actual existence (the basis) determines sign and *how* sign reflects and refracts existence in its process of generation" (19). Because of their "social ubiquity," their implication in every contact between people, words are a "sensitive index of social changes" (19). Through studying verbal interaction, the social analyst has a means of documenting the filtration and refraction into human communication and ideation of shifts in the economic pattern of a society.

> The word is the medium in which occur the slow quantitative accretions of those changes which have not yet achieved the status of a new ideological quality, not yet produced a new and fully-fledged ideological form. The word has the capacity to register all the transitory, delicate, momentary phases of social change. (19).

Vološinov describes a series of speech genres—particular forms and types of speech (e.g., office gossip)—which have a close connection to the social situation in which they occur, and he argues that an urgent task for Marxism is the compilation of a typology of such speech genres. This is important because in their dynamics, motivated by alterations in the material basis of the society, may be traced the semiotic shifts which later accrete to form wholly articulated ideologies. The tracing of these semiotic shifts through the network of speech genres provides one means of relating base and superstructure. In order that an item of reality enter the behavioral and cognitive domain of a social group in a way that may elicit semiotic response, that item "must somehow, even if only obliquely, make contact with the bases of the group's material life" (22).

But signs do not only reflect, they also refract, social reality. A fundamental difference exists between class and the sign community. Different classes may draw upon the same language. "As a result, differently oriented accents intersect in every ideological sign. Sign becomes an arena of class struggle" (23). One of Vološinov's important contributions is his insistence that class and the sign community are divergent. Here, Vološinov's Marxism is an important analytic tool be-

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cause it forces recognition of the structuring importance of class differences. The fate of the concept of class in sociology indicates why this recognition is important. From the perception of class conflict in Weberian sociology, the concept of class decayed into a passive and purely formal status in American functionalism, in which the normal social state was seen as one of stasis and equilibrium among different social groups. Similarly, philosophical systems centering upon the sign face a danger of denying the presence of social differentiation and conflict through reliance upon notions of an abstract or ideal sign community. (George Herbert Mead's *Mind, Self, and Society*, for example, contains formulations of the sign and of linguistic intersubjectivity which are similar to Vološinov's. However, Mead's notions of society lack concrete, historical formulation, and his work contains ample illustrations of the political implications of assuming the presence of an ideal sign community.)[2]

Since class and the sign community are divergent, language becomes polyvalent, multi-accented, from a class perspective. The pressures of social struggle, the intersection of differing accents, keep a sign dynamic and maintain its development. Signs withdrawn from competing class perspectives degenerate into ossified, allegorical forms. For Vološinov, the interests of the ruling class are in making the sign uniaccentual, in extinguishing the play of dialectical forces across the surface of the sign. This is an important insight and not without historical application. The unleashing of the Cold War under Truman, for example, is comprehensible in semiotic terms as an attempt to destroy the polyvalence of the sign "communism" and to substitute a narrow, uniaccentual range of meanings. Vološinov's perception of the relation between semiotic accent, social power, and class struggle is among the sharpest analytic tools bequeathed by his study.

Vološinov vs. Saussure

As Vološinov developed his notion of the symbiotic connection between social context and the circulation of signs, he took a stand against, and developed a critique of, a powerful current within linguistic analysis which he termed "abstract objectivism" and whose most famous representative at the time was Saussure (today, Noam Chomsky is the leading exponent of this position). Vološinov disputed the key assumptions of Saussurean linguistics and sought to redraw the boundaries of the discipline in a different configuration.

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In a series of courses in general linguistics given at the University of Geneva between 1906 and 1911, Saussure described the shape and direction of linguistic study as he saw it; this orientation is disputed almost point by point by Vološinov. Saussure felt the proper object of linguistic study was the set of organizing rules and principles underlying and informing speech acts. This set of underlying principles he termed *langue*. Although they existed outside the consciousness of speakers, they were manifest in every utterance (and constituted the grammaticality of the utterance). The actual speech act itself Saussure regarded as epiphenomenal, as a function of the style or individual temperament of the speaker, and therefore outside the province of linguistic inquiry. *Langue* was the arena of the social, whereas the speech act (*parole*) was a matter of individual peculiarity. (In contemporary terms, a similar orientation is formulated by Chomsky, who substitutes notions of "competence" and "performance" for Saussure's *langue* and *parole*.) Furthermore, Saussure separated the diachronic perspective (linguistic change occurring over time) from the synchronic perspective (the state of a language system at one moment in time). For the linguist, Saussure argued, only the synchronic mattered.

Vološinov located the roots of Saussurean linguistics in the rationalism of the seventeenth and eighteenth centuries. It was a Cartesian orientation with a "cult of autonomous, rational, fixed form" (57) and an essentially mathematical model of language:

> What interests the mathematically minded rationalists is not the relationship of the sign to the actual reality it reflects nor to the individual who is its originator, but the relationship of sign to sign within a closed system already accepted and authorized. In other words, they are interested only in the inner logic of the system of signs itself, taken, as in algebra, completely independently of the ideological meanings that give the signs their content. (57–8)

For a dialectual materialist, history (diachronics) could not be separated from language, nor could a language be regarded as a closed, autonomous system, in which the only relational terms admitted were those occurring between signs. Saussurean linguistics commits an error by abstracting an idealized underlying system (*langue*) from the living, dynamic verbal transactions of members of a speech community. It is here, Vološinov maintains, that true sociality is found: in the verbal utterance, not in a set of abstract rules. For him, the proper subject of linguistics is the utterance, which admits the social. The utterance functions as a binary sign, its two terms being the speaker and the addressee, operating within a social space.

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"In point of fact, word is a two-sided act. It is determined equally by whose word it is and for whom it is meant. As word, it is precisely the product of the reciprocal relationship between speaker and listener, addresser and addressee" (86). Vološinov does not neglect the underlying structural features of language. Their importance is indicated in the third section of the book, where the analysis of reported speech demonstrates various structuring principles operative in different languages for the grammatical marking of "speech within speech." But these underlying rules are not the primary objects of analysis, for they are not the point of contact between the language system and the material of history.

Vološinov, then, inverts the terms of Saussurean linguistics so that history, politics, and ideology might enter the sign. He illustrates this by a discussion of how an experience of hunger might be inflected by various kinds of verbal utterances depending on social context. For example, where hunger is experienced by "one of a disparate set of hungry persons whose hunger is a matter of chance" (88) (e.g., a beggar), various ideological forms might accent the utterance: "the individualistic protest of a vagabond or repentant, mystical resignation" (88). In a collective where hunger is experienced "at large," where members are loosely knit so that conditions of material separation obtain, "a resigned but unashamed and undemeaning apprehension of one's hunger will be the rule under such conditions—'Everyone bears it, you must bear it, too' " (88). By contrast, in a politically mobilized collective, the utterance will take the form of active and aggressive protest.

> All these types of expression, each with its basic intonations, come rife with corresponding terms and corresponding forms of possible utterances. The social situation in all cases determines which term, which metaphor, and which form may develop in an utterance expressing hunger out of the particular intonational bearings of the experience. (89)

Utterance is a sociopolitical phenomenon, and by abstracting from the living texture of speech performances, Saussurean linguists ossify and deaden their object of study. A Marxist study of language must take the utterance as the real phenomenon of language, as its socioideological form. Vološinov outlines his model in the following terms:

> The generation of language . . . is a factor in the generative process of social communication, a factor inseparable from that communication and its material base. The material base determines differentiation in a society, its sociopolitical order; it organizes society hierarchically and deploys persons interacting within it. Thereby are the place, time, conditions, forms and

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> means of verbal communication determined and, by the same token, the vicissitudes of the individual utterance in any given period in the development of language, the degree of its inviolability, the degree of differentiality in perception of its various aspects, the nature of its ideational and verbal individualization. And this finds expression above all in stable constructions of language, in language patterns and their modifications. (153).

The issues with which Vološinov grappled are, today, far from settled, and this makes the book, though written in 1929, seem quite contemporary. The dispute continues over whether language is best studied in terms of underlying syntactic rules of formation or in terms of features of the social context of the community of speakers. On one side ranges the transformational grammar of Chomsky, on the other, the adherents of a sociolinguistic orientation. However, both camps admit that a political dimension is inherent in any definition of the field of linguistics. Not surprisingly, both sides lay claim to an emancipatory, humanizing politics. Chomsky cautions against views of the malleability of human nature common among the left:

> . . . a deeper look will show that the concept of the 'empty organism,' plastic and unstructured, apart from being false, also serves naturally as the support for the most reactionary social doctrines. If people are, in fact, malleable and plastic beings with no essential psychological nature, then why should they not be controlled and coerced by those who claim authority, special knowledge, and a unique insight into what is best for those less enlightened?[3]

He argues that a Cartesian model, emphasizing innate, underlying cognitive structures and rule-governed creativity, provides a framework capable of asserting the dignity of the person and the importance of participation in a free and just community. However, Chomsky's studies of language have been criticized from a sociolinguistic perspective on the grounds that they neglect real, differentiated groups of speakers in favor of a homogenized, universal community:

> In such respects a conception of linguistic theory concerned exclusively with an ideally fluent speaker-listener in a perfectly homogenous community . . . may unwittingly play into the hands of those whose views about people the theory's exponents would wish to reject. . . . The entire theoretical potential of the formal system is imputed willy-nilly to all individual speakers. Such reliance on one's own sense of communicative conduct can result in unintended intellectual and social 'imperialism,' at-

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tributing parochialisms to the rest of the society in the name of the frontiers of theory.[4]

A political conception of mind and human life is implicit in models of language and its use. Chomsky's defense of Cartesian rationalism is articulate and persuasive, and, indeed, some emphasis on underlying syntactic structures is a requisite of any linguistic inquiry. On the other hand, as Vološinov demonstrates, social structure enters into language use in many ways, so that linguistic accounts based on a set of formalized rules in a closed system simply won't do. Just as synchronics and diachronics remained eternally sundered in Saussurean theory, formalistic and socially contextualized linguistics have remained antagonists. The two positions constitute opposing tensions of a frozen dialectic, and the necessary synthesis will entail breaking new theoretical ground.

In the meantime, Vološinov's study stands as a compact introduction to the importance of the sociological element in linguistic theory. The formulations are supple, and he is a dialectician unafraid of complicating detail. Moreover, his isolation of language as the mediating link between base and superstructure earns him an important place in the history of Marxist philosophy. The perception of the materiality of ideology—and of language as the ideological phenomenon par excellence—is a necessary methodological insight for contemporary studies of ideology. Vološinov demonstrates the insufficiency of conceptions of ideology which equate it with "ideas," "spirit" or "consciousness." For the general reader, moreover, the study provides a clear account of the implications of the semiological ripple that has spread across the human sciences in this century.

NOTES

1. *K. Marx, F. Engels, V. Lenin: On Historical Materialism* (Moscow: Progress Publishers, 1972), 137.
2. George Herbert Mead, *Mind, Self, and Society* (Chicago: University of Chicago Press, 1962). See Mead's discussion of society, especially 281–311.
3. Noam Chomsky, *Reflections on Language* (New York: Pantheon Books, 1975), 132.
4. Dell Hymes, *Foundations in Sociolinguistics* (Philadelphia: University of Pennsylvania Press, 1974), 95.

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David Boonin-Vail

THE PARTHENON PAPERS

THE TRIAL OF SOCRATES

by I. F. Stone

Boston: Little, Brown and Co., 1988. 282 pp., $18.95

Stone's attempt to "mitigate" the Athenian verdict against Socrates is disputed. Stone's argument that Socrates was guilty of teaching future tyrants amounts to guilt by association. Stone's claim that Socrates' philosophy presented a serious threat to Athens is incorrect. Socrates' view of human society as a herd was harmless, since he considered himself a loyal part of it. His insistence that knowledge lies in definitions is not shown by Stone to be dangerous, because Stone fails to show that it is misguided. And Socrates' defense of the individual soul as the seat of virtue proves no threat, since his own life demonstrates that it is perfectly compatible with good citizenship.

The late I.F. Stone's final book, *The Trial of Socrates*, has already earned the sort of praise which would surely have warmed the Athenian philosopher's heart. Sidney Hook, for example, wrote that "Mr. Stone's jeering remarks about Plato's philosophical doctrines are those of a cultural philistine." Allan Bloom has labelled the work "implausible" and "often tiresome."[1] Stone, then, like Socrates, can rest assured that his penetrating questions have been effective not because they have produced agreement, but because they have generated controversy.

For over two thousand years, the trial and execution of Athens' most famous gadfly have been viewed as an unmitigated disgrace, and Socrates as a noble martyr. Now Stone, the talented and thorough investigative reporter, has attempted to reconstruct "the missing case for the prosecution." As he explains in the book's preface, "I could not defend the verdict when I started and I cannot defend it now. But I wanted to find out what Plato does not tell us, to give the Athenian side of the story, to mitigate

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the city's crime and thereby remove some of the stigma the trial left on democracy and on Athens."

Although obscured by the limited records of antiquity, a few basic facts about the case remain clear. Socrates was tried in 399 B.C. on the charge of "corrupting the minds of the young, and of believing in deities of his own invention instead of the gods recognized by the state." He was found guilty by a vote of 280 to 220, and sentenced by a substantially wider margin to drink the hemlock. What is not clear, though, is why the charges were made, and why the jurors voted to sustain them. "How," Stone asks, "could the trial of Socrates have happened in so free a society? How could Athens have been so untrue to itself?"

One answer to this question is provided by Socrates himself in Plato's *Apology*. When he was younger, he explains in his speech to the jurors, the oracle at Delphi had declared that there was no one wiser than Socrates, and this pronouncement had inspired him to seek out those of reputed wisdom. The quest for knowledge upon which Socrates subsequently embarked had the effect of revealing the ignorance of the most prominent citizens of Athens (significantly, it was the ignorance of the politicians which Socrates first uncovered). This no doubt made Socrates extremely unpopular with those in positions of power, while at the same time endearing him to the young aristocrats who found the spectacle of the Socratic inquisitions entertaining. Thus Socrates notes in the *Apology* that in his trial he is really under attack from two sets of critics, the prosecutor in the present case, and the enemies he has made through a lifetime of philosophizing. And it is the latter, he claims, who present a greater threat to him now.[2] On his own account, then, as Plato presents it, Socrates believed that his trial could best be understood as the retribution exacted by those who had been offended by his noble search for truth.

This explanation has largely served as the basis for the popular understanding of Socrates' martyrdom, but Stone correctly recognizes that we should not simply take Plato's word for it. Instead, combining a thorough analysis of the ancient texts with his own passion for investigative journalism, Stone mounts a powerful attack on Socrates that issues in two charges: that Socrates differed profoundly from his contemporaries on three fundamentally important philosophical questions, and that he was viewed as the anti-democratic teacher of aristocrats such as Alcibiades and Critias, who had gone on to betray the democracy of Athens. It was for these two reasons, Stone argues, that Socrates was tried, convicted, and ultimately put to death.

The second half of Stone's thesis is unremarkable. As Stone himself notes, it was formulated as early as 345 B.C. by the orater Aeschines, who

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argued that the Athenian jury "put to death Socrates the sophist . . . because he was shown to have been the teacher of Critias, one of the Thirty who put down the democracy." And in his classic study of Socrates, the twentieth-century scholar A.E. Taylor noted that at the trial it was "Socrates' misfortune" that, because of the cases of Critias, Charmides and Alcibiades, there was a general impression that he had been "educating traitors."[3] More important than its lack of novelty, however, is the fact that this claim does little to "mitigate" the Athenians' crime. It is true, as Stone writes, that "the denigration of democracy and of common men is a recurrent theme" of Socrates, at least as he is represented in the writings of Plato. But when Stone adds that this "might be seen as justifying or encouraging power-hungry men to overthrow the democracy," he is treading on extremely thin ground. There is no evidence to suggest that Socrates advocated or supported overthrowing the democracy, and to condemn every citizen who "might be seen" as "encouraging" such behavior would surely have strained the Athenian supply of Hemlock. Stone's second charge, then, though documented in admirable detail, amounts ultimately to little more than guilt by association.

The first half of Stone's thesis, however, is intriguing and merits more detailed consideration. His charge is that certain of Socrates' philosophical positions were simply incompatible with the existence of a democratic Athens. "Taken seriously," he writes at one point, "they would have brought the life of the city to a halt." And "the negative dialectic of Socrates," he writes at another, "would have made equity and democracy impossible." Stone's argument, then, is that Athens killed its most famous citizen not out of revenge for the irritation he had caused it, but rather in self-defense. How shall we evaluate this startling claim?

Before turning to the three philosophical questions which Stone considers, it is necessary to make one point about his method. Although Stone does an admirable job in piecing together what little information about Socrates survives in the works of writers such as Xenophon and Aristophanes, to understand Socrates' philosophy he is forced to rely largely on the dialogues of Plato. Now, it is generally agreed that Plato's works may be divided roughly into three periods. While little can be said about this with certainty, it seems safe to say in general that in Plato's early dialogues, such as the *Apology*, he is representing Socrates essentially as he was, that in middle works such as the *Republic* he is beginning to develop his own ideas using Socrates more as a dramatic figure, and that in his later works such as the *Sophist* the role of the historical Socrates becomes almost negligible. Stone neglects this widely accepted analysis, and this

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at times undermines his claims about Socrates' philosophy. He cites the *Theaetetus*, for example, as evidence of the subversive nature of Socrates' arguments, but that dialogue is almost certainly one of Plato's later works, and it is not at all clear what, if anything, it reflects of Socrates' actual thought. And for all his detailed research, Stone nowhere considers the tradition kept alive by the ancient skeptics which held that Socrates himself remained always a questioner and never took a positive position on any philosophical question. Considerations such as these tend to cast doubt on how much Stone may legitimately infer about Socrates' philosophy beyond what is clearly indicated in Plato's early dialogues. We will nonetheless give Stone the benefit of the doubt, and proceed on the assumption that what he says about Socrates' philosophy is essentially correct. The question, then, is whether this should in any way change our evaluation of his trial and execution.

The Nature of the Human Community

The first and "most fundamental" philosophical disagreement which Stone identifies between Socrates and his fellow Athenians, is over the nature of the human community. The typical citizen of Athens, Stone argues, viewed the ancient *polis* as an assembly of free men who lived together naturally and ruled over themselves in dignity and equality. Like Aristotle in the *Ethics*, they viewed man as being by nature a "political animal." Socrates, on the other hand, viewed human society as nothing more than a herd in need of a master, or—in the case of the *Republic*—a philospher-king, to rule over it. Stone leaves no doubt as to where his sentiments lie on this question. His book is filled with loving praise for what he sees as the common-sense views of Aristotle, and undisguised contempt for the elitism of Socrates. Nor does he hide his idealization of the ancient city-state. "The planet will not be safe," he speculates at one point, "until it, too, becomes a *polis*." The question, though, is whether Socrates' position on this question could legitimately have been viewed as posing a threat to the Athenian way of life.

There is one overwhelmingly important fact which makes this seem unlikely, and it is a fact with which Stone never fully comes to terms in his book: Socrates, though always a powerful critic of Athens, remained to the end its loyal citizen. He fought bravely in its defense during the Peloponnesian War, refused to take part in acts against it in the twilight of its greatness, and, perhaps most importantly, turned down the chance to escape its judgment, because he felt it was his duty to obey it. The fact

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of Socrates' loyalty, moreover, is not inconsistent with his claim about the nature of the human community, and for a simple reason which Stone overlooks: Socrates considered himself to be a part of the herd. Many of his fellow citizens may, like Stone, have found this view of humanity distasteful, but they were unlikely to find it dangerous. Stone is right to say that this philosophical disagreement was "no trivial difference." It has many important implications for how people should be governed. But the fact that Socrates forced the Athenians to think more critically about their most deeply cherished institutions does not in itself render him a bad influence. Had he convinced the majority of Athenians to embrace his views and had they then decided to act upon them, this would have been entirely consistent with the democratic process as it was practiced in ancient Greece. Nor, if he failed to convince them, would he pose any greater threat to their way of life. In fact, Socrates was never interested in swaying political assemblies, and his ideal of what might best be described as enlightened despotism remained always a minority view. As Stone himself surprisingly concedes at one point, "In fifth- and fourth-century Athens, advocacy of kingship must have looked as quirky as a monarchist political party would in twentieth-century America—too quaint and eccentric even to be alarming." But if Socrates' view of the human community was so unpopular as to prove irrelevant, then it cannot serve as a reasonable explanation, let alone justification, of his trial.

The Socratic Search for Definitions

The second philosophical issue which Stone considers is Socrates' concern for definitions of things in general, and of knowledge and virtue in particular. His argument here is two-fold: that Socrates' quest for absolute definitions was nothing but a "wild goose chase" fueled by "stratospheric nonsense" and "gross oversimplifications," and that the continual negative results of his search for definitions undermined the authority of the *polis*, by questioning the wisdom of its leaders.

Stone presents two somewhat incongruous arguments for the first of these claims. He argues both that for two thousand years serious philosophers have taken the problem of definitions seriously and failed to resolve it, and that the problem is chimerical and can easily be seen as such by anyone with the least amount of common sense. As for the first of these arguments, it is difficult to deny that in this, as in many other areas of inquiry, intense philosophical discussion has failed to produce agreement. As Stone notes, "philosophers have not yet been able to decide what a

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definition *is*, much less to determine whether any perfect definition is achievable." But while many of the questions which Socrates was the first to raise have not yet been answered, it is not clear that this makes Socrates wrong for having raised them. And even if, in hindsight, this were to temper our evaluation of him as a philosopher, the future collapse of the Socratic project would not have been an argument available to his contemporaries.

For this reason, Stone's second argument for the futility of Socrates' search for definitions is more significant. He claims that anyone, even in Socrates' day, should have been able to recognize the flaw in the Socratic method. There can be no absolutes, Stone argues, because "things constantly change" and because specific circumstances may alter the applicability of general principles. This position may seem sound, but the example with which Stone illustrates it inadvertently demonstrates that the Socratic problem runs much deeper than Stone realizes. Consider the definition of virtue. Surely, Stone says, telling the truth must play an important part in it. But, he asks, is telling the truth always good? Is it good to tell a dying friend the truth about his unfaithful wife (Stone's example), or is it better to soothe him with a harmless lie? Now Stone assumes, and all but a few Kantians would agree, that virtue need not preclude telling such a lie. But what, if anything, does this prove about the Socratic search for definitions? Stone maintains that it shows that "even the most fundamental notions of virtue and justice may depend . . . not on the universals Socrates sought but on the particular circumstances." This statement, however, is ambiguous in a fundamentally important way. Clearly it is true that what virtue requires may vary from case to case: in one case it may require telling the truth, and in another case it may require lying. But this is not the same as saying that virtue itself varies from case to case. Indeed, Stone as much as admits this when he adds that his example shows that "in the agonizing choices with which real life so often confronts men and judges alike, true virtue, humanity, and kindness may call for bending the rules, sometimes considerably." So there is, according to Stone, such a thing as "true virtue" after all. But what is it? If Stone is so certain that it exists and what it requires, Socrates might well ask, then perhaps he can tell us what it is. Asking this question, then, as Socrates persisted in doing, seems simply to be the natural conclusion to Stone's argument.

That Stone's own analysis is perfectly compatible with the Socratic project should come as no surprise to students of Plato. For in an early passage of the *Republic*, Socrates makes virtually the same point that Stone would make thousands of years later. When Cephalus suggests that justice

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may be defined as truthtelling and paying back one's debts, Socrates notes that there are important exceptions to this rule. If one borrowed weapons from a friend who later went mad, for example, justice would not require giving them back to him.[4] But this fact, Socrates correctly recognizes, means only that this rule is not the definition of justice—not that justice is variable and undefinable. Indeed, the fact that both Cephalus and Socrates agree that there is something called justice which requires truthtelling in one situation and lying in another seems to suggest that justice itself is a constant. Stone's arguments, then, do not convincingly reveal anything philosophically irresponsible about Socrates' approach to questions of virtue and justice.

But perhaps, as Stone's second argument claims, there is something civically irresponsible about the Socratic method. Democracy requires, at its foundation, a belief in the wisdom of the people and their leaders. And this, Stone contends, was seriously undermined by the pestering questions of Socrates. If no one really knew anything, after all, then why obey the rulers, or, for that matter, the rules? At this point in the argument, however, Stone is confronted with a nasty dilemma. On the one hand, Stone adamantly maintains that the people of Athens, and particularly their civic leaders, were great men worthy of the highest respect and loyalty. "If ever a city deserved the full energy and devotion of its citizens," he writes, "that city was Athens." On the other hand, he insists that Socrates' arguments were simplistic, sophistic, and irrelevant. Yet his charge here is that Socrates was guilty of corrupting the youth because he taught them "an easy way to make laughingstocks of the leading citizens, the officials of the city . . . and of course the *hoi polloi*, the ignorant many, who presumed to vote on public questions in the assembly." The question which must inevitably be asked, then, is: if the leading Athenian citizens were so wise and Socrates so foolish, how is it that he so easily made fools of them? Were they less great than Stone would have us believe, or was Socrates more wise? The answer, of course, is a little of both. But it is difficult to avoid the conclusion that the questions which Socrates was among the first to ask, and which he made it his business to persist in asking, were both serious and significant. What is knowledge? What is virtue? How ought people to be governed? Stone is right to say that these questions are not easily answered, but he is wrong to think that they are easily avoided. Every society, implicitly if not explicitly, must reach at least tentative answers to these questions. And since Socrates did more than anyone of his time to bring them to the public eye, his vigorous questioning should be viewed more as a public service than as a public nuisance.

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The Good Life

The third and final philosophical question which Stone considers concerns the nature of the good life: is it to be found in the individual, or in the community? Stone complains that Socrates was, to the very end, an unrepentant individualist. Now, the charge of individualism may come as somewhat of a surprise to students of Plato's political philosophy. In the *Republic*, after all, Socrates endorses, among other things, the abolition of private property, a system of selective eugenics, and censorship of the great poets—hardly hallmarks of a good individualist. But Stone is right to see that in at least one fundamental respect, Socrates was a harbinger of individualism in an age of communal values. While most Athenians shared the classical view that happiness and excellence in life came from participation in the *polis*, Socrates preached, by both his words and his actions, withdrawal into a more private sphere. Socrates was arguably the first person in the Western tradition to locate the source of man's well-being in his *psyche*, or soul, a personal and intimate seat of virtue beyond the reach of the rest of the community.[5] And this, as Stone recognizes, had profound implications for the relationship between the Athenian and the *polis*. For if the way to virtue and happiness lay within one's own soul, rather than in the common good of the community, then it was to one's own soul that one owed one's primary loyalty. This was how Socrates lived his life, following the muse which inspired him, no matter how far from the rest of his society it led him. Socrates was a questioner, an idealist, a non-conformist. He chose to seek satisfaction by his own lights, rather than by joining in the collective pursuit of virtue that comprised life in the *polis*. It is in this sense that Socrates was a true individualist, and it is for his individualism, above all else, that Stone cannot forgive him. For as a result of it, Stone says, "Socrates was not a good citizen . . . [I]t is extraordinary that so prominent an Athenian managed in his seventy years to take almost no part at all in civic affairs." And again, "the Socratic gadfly never seemed to be around when its sting was most needed. Socrates never raised his voice in the assembly when the fateful decisions of his lifetime were made." Socrates' greatest sin, then, in Stone's eyes, was a sin of omission. In the greatest participatory democracy of antiquity, Socrates chose to be a non-participant.

But did Socrates' withdrawal from and criticisms of the Athenian community make him its enemy? It is here that Stone seems most seriously to have failed to learn from the tragic mistake of Socrates' persecutors. For as Socrates' noble life demonstrated, there is an enormous difference between withdrawing from politics, even in the broadest sense in which

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that word was then understood, and withdrawing from humanity. Socrates never took an interest in addressing the official assemblies of his day, but he was nonetheless an influential thinker. He did not seek happiness through the *polis*, but he did find it through the community—the community of his friends. And despite Stone's judgment to the contrary, he was a good citizen, better, probably, than most. He was, of course, a sharp critic of democracy, but then, as Stone himself repeatedly reminds us, one of Athens' strengths lay in the vigorous debates which filled its assemblies. There was, then, nothing about Socrates' life as a philosopher that was truly inimical to the existence of Athens.

None of the three philosophical differences between Socrates and the Athenians which Stone identifies, then, prove great enough to "mitigate" the tragedy of Socrates' trial and execution. Socrates was, to be sure, a dissenter, but there were many of these in Athens, and it was not the city's policy that they be made to drink hemlock for their dissent. Stone's two-fold explanation of Socrates' trial, therefore, ultimately fails as an apology. The first claim, that Socrates was hated as an anti-democratic teacher of the young aristocrats, is no doubt true, but hardly justifies his death. And the second, that Athens killed Socrates in an act of philosophical self-defense, is not sufficiently justified. Stone has indeed done an admirable job, given the scarcity of evidence and the reputation of the accused, in reconstructing the missing case for the prosecution. But in the end, the case for the defense seems far stronger.

NOTES

1. Sidney Hook, "Making the Case Against Socrates," *The Wall Street Journal*, January 20, 1988: 26; Allan Bloom, "Dateline Athens: I. F. Stone Reopens the Socrates Case," *Washington Post Book World*, February 14, 1988: 14. Stone has received more sympathetic reviews from, among others, Bernard Knox ("Why Socrates Was Killed," *The Atlantic*, January 1988: 91–4) and M.F. Burnyeat ("Cracking the Socrates Case," *New York Review of Books*, March 31, 1988: 12–18).
2. Plato, *Apology*, in *The Last Days of Socrates*, trans. Hugh Tredennick (Harmondsworth, Middlesex: Penguin Classics, 1954), 18d–e.
3. A. E. Taylor, *Socrates: The Man and His Thought* (New York: Doubleday and Company, 1952), 100. Although Stone justly refers to Taylor as "one of this century's greatest—and most devout—Platonic scholars," he nowhere refers to this authoritative work which offers a clear and reasonable account of Socrates' life, and anticipates Stone's account on many points.
4. Plato, *Republic*, 331c.

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5. Taylor, for one, supports this view. "It was Socrates who, so far as can be seen, created the conception of the *soul* which has ever since dominated European thinking" (132).

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David Felix

CONSUMING OUR WAY TO GREATER WELL-BEING: THEORY AND HISTORY

Keynes is widely accepted to have proved the existence of a consumption gap as a cause of economic depressions. Such a gap meant that, ironically, depressions could get worse as a result of the greater wealth produced by the modern economy, since, as Keynes argued, the wealthy consumed proportionately less than the lower-income groups. Textual analysis, however, shows that Keynes's arguments amounted to assumptions, not demonstrations. And a survey of the empirical research of the subsequent half-century reveals a lack of convincing evidence of the consumption gap.

It is often believed (and taught) that John Maynard Keynes, the West's dominant economist since the 1930s, showed in his *General Theory of Employment, Interest and Money* that lagging consumption was a major cause of depression, with unemployment and all the related economic distress. Indeed, consumption and the interest rate are the two pillars on which his classic of 1936 rests. Left to themselves, *The General Theory* argued, consumption fails to consume enough of what is produced, while the interest rate remains too high, preventing business investment from taking up the slack in consumption by making use of all of the available savings. The situation is made all the worse, the logic continues, because as the modern economy generates more wealth, most of it goes to the more prosperous persons who, *proportionately*, do most of the saving and the least of the consuming. On this basis some Keynesians reasoned that measures tending to redistribute and

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equalize incomes would eliminate the consumption gap and thus serve the demands of economic efficiency as well as those of economic justice.

In this inquiry I shall confine myself, without prejudice to the important question of the interest rate, to consumption. Although it receives less attention now from economists than it used to, Keynes's hypothesis about consumption has informed the thinking of non-economists interested in whether income redistribution has any economic, rather than ethical, rationale. It also constitutes an important chapter in the intellectual history of Keynes's thought.

Keynes's *General Theory* never quite made his case against consumption, although, first anticipating and then following his account of the "consumption gap," he argued as if he had, in fact, done so. Early, in an introductory passage, Keynes promised:

> This analysis supplies us with an explanation of the paradox of poverty in the midst of plenty. . . .
>
> Moreover the richer the community, the wider will tend to be the gap between its actual and its potential production; and therefore the more obvious and outrageous the defects of the economic system. For a poor community will be prone to consume by far the greater part of its output . . . whereas a wealthy community will have to discover much ampler opportunities for investment if the saving propensities of its wealthier members are to be compatible with the employment of its poorer members.[1]

Compounded in this argument was the powerful implication that the equalization or redistribution of incomes would improve general economic well-being. Sixty-five pages later Keynes arrived at the heart of his very brief direct analysis of consumption, the two-page Section III of the main chapter (of two) on consumption.[2] At the end of Section III, however, disregarding the ambiguities he had just committed to print, he again found a consumption gap requiring an (unlikely) increase in investment to be filled.[3] Similarly, the rest of the two consumption chapters, later passages in *The General Theory,* and other writings of Keynes referred to this gap as an established fact.[4] We double back to the essence of Keynes's argument on consumption.

"A higher absolute level of income will tend, as a rule, to widen the gap between income and consumption," Keynes began his argument. "For the satisfaction of the immediate primary needs of a man and his family is usually a stronger motive than the motives towards accumulation, which only acquire effective sway when a margin of comfort has been attained." That was all the argument, but Keynes's thesis leapt to its conclusion in the next sentence. "These reasons will lead, as a rule, to a greater *proportion* of income being saved as real income increases. But whether or not a greater proportion is saved. . . ."[5] One must interrupt Keynes here to puzzle out this ambiguous statement. Two expert readers drew diametrically opposed senses from it. In his review of *The General Theory* Frank H. Knight,

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a leader of the Chicago school of economists, complained of the ambiguity but concluded that Keynes was positing only an *absolute* increase and not necessarily a *proportionately* greater amount saved.[6] Another economist assumed the contrary in the *Quarterly Journal of Economics* of November 1938. Asked for clarification by a colleague who saw the latter review, Keynes, besides assuring his colleague in that sense, published a long letter specifying an *absolute* increase in the amount saved in the journal's issue of August 1939.[7] With this statement defining the limits of his claim, Keynes had permitted his fundamental argument on consumption to abort itself at birth.

For if merely a greater absolute amount of income were saved, the consequence would not be a consumption gap at all (leaving aside, of course, Keynes's contention that excessive savings—or hoarding—make for a gap of a different sort because interest rates fail to coordinate savings with investment). This was why Knight had "puzzled some time over the question as to just why the author so emphasized the increase of saving with increased income, making the natural assumption that an increase meant an increased proportion."[8] Thus, if a given economy had achieved full employment at, say, a proportion of 90% consumption and 10% saving, and if income increased, a greater *absolute* amount of savings would have to take place simply to maintain the 9–1 consumption-saving ratio. The danger of deficient consumption would arise only if a greater *proportional* amount were saved (and, correspondingly, a lesser *proportional* amount were consumed). If income were doubled, say, from $100 billion to $200 billion, the 9–1 ratio would not change if saving also doubled, going from $10 billion to $20 billion, an absolute but not a proportional increase. If, however, savings had increased only to, say, $15 billion, then there would have been an absolute increase but a proportional *decrease,* saving falling from 10% to 7.5% of income (and a proportional *increase* of consumption from 90% to 92.5% of income). If saving, had, instead, gone to $40 billion and 20% of income, this would indeed have been a proportional increase. The consumption-saving ratio would have fallen from 9–1 to 4–1, with a consumption gap resulting in a failure to consume everything produced and a condition of disequilibrium, deflation, and depression (assuming the validity of Keynes's assessment of the inadequate coordinating properties of the interest rate). This would provide a strong argument for income redistribution.

But if, as Keynes had written initially, the proportional saving increase was only *likely* but not *certain,* then his logic cannot proceed as if the alternative possibility were non-existent—surely not after he had himself proposed it: "whether or not a greater proportion is saved. . . ." In any case, while later positing only an absolute increase, he had adduced no facts and only exiguous argument in *The General Theory* to suggest the *likelihood* he claimed to perceive. In his precision in the *Quarterly Journal of Economics,* he put it: "I give reasons for expecting that, *as a rule,* a greater *proportion* of income will be saved, as real income increases." He had, in fact, not given plural reasons but the singular speculation on the consumption motives of "a man and his family." Keynes went on to grant,

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"This is a mere statement of opinion, which requires more statistical examination than I have given it. . . ."[9]

The example of the family man, moreover, raised other questions. In the same paragraph Keynes had gone from the saving pattern of "a man" to that of "any modern community," as if there were no difference between them. Is he taking the "man" or the "man and his family" as a model of the community or is he anthropomorphizing the community? In logic Keynes has no right to transfer such patterns between the two as if there were no significant difference between them. Indeed, eleven pages later, he remarked on "the large amount of income, varying perhaps from one-third to two-thirds of the total accumulation in a modern industrial community . . . which is withheld by Central and Local Government, by Institutions and by Business Corporations"—he had to distinguish these savers from individuals or individual households, and he continued:—"for motives analogous to, but not identical with, those actuating individuals. . . ." With this admission Keynes granted that his argument risked being a non sequitur to the extent of the magnitude of institutional saving. However "analogous" the motives of such institutional savers might be, their saving rationale and pattern were so different from individual actions that they required separate studies, something *The General Theory* did not attempt beyond conceding certain differences.[10] Yet Keynes's argument proceeded as if the essential characteristics of saving flowed from his family man.

Keynes had already developed another dubious argument in the space provided by his (unproven) consumption gap. Thus *The General Theory* had the gap threatening to reduce the need for production, and hence for employment. In a "digression," as he called it, on capital expansion in Britain and the United States, he asserted forebodingly that the more capital created in the past, the less would be needed in the present and future. This carried further, although without substantiation, "the explanation of the paradox of poverty in the midst of plenty," as promised in the introductory passage. Keynes concluded now, "The greater, moreover, the consumption for which we have provided in advance, the more difficult it is to find something further to provide for in advance, and the greater our dependence on present consumption as a source of demand."[11] The whole argument had proceeded with specific reference to the Depression, as if the consumption gap, with all its ambiguity, had to have concomitantly *depressive* effects.[12] But the force of the argument is based on the assumption of *disproportionate* increases in saving; merely absolute ones would leave consumption with its healthy hunger for more that has kept capitalistic economies expanding to this moment.

Later, after having emerged from the book, Keynes seems to have completed the process of believing what he set out to prove: the fact of a greater *proportional* amount saved. This is the sense of it as expressed in a letter to his protégé and future biographer Roy Harrod, when he remarked on what he saw as the great breakthrough in his thinking that led to his *General Theory*. It came, he recalled, after "I had enunciated to myself the psychological law that, when income

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increases, the gap between income and consumption will increase, — a conclusion of vast importance to my own thinking. . . ."[13] A few months after this letter, defending the book against four economist-critics, Keynes repeated the same thought on the consumption gap with almost the same words in his important article, "The General Theory of Employment": "This psychological law was of the utmost importance in the development of my own thought. . . ."[14] In neither instance did Keynes specify that the gap would be proportionately greater, but the conception would not have had the importance he attributed to it if it had merely meant an absolute increase.

The Keynesian conception of the income-consumption/saving relation breaks down because what is stated as a psychological law is, in fact, an open empirical question. Nevertheless, Keynes proceeded as if his model had worked perfectly. Loyal readers followed. Vast research activities, particularly in the empiricist United States, endeavored to undergird his argument with established or newly assembled facts describing a modern economy.

In *The General Theory* itself Keynes could test his ideas against earlier research by the pioneering economic statisticians Colin Clark and Simon Kuznets. Keynes had to content himself with a cautious reading. He found the Kuznets figures "very precarious." Moreover, "if single years are taken in isolation, the results look rather wild." Undeterred, he found more acceptable figures if the years were (arbitrarily) taken in pairs, namely, "a marginal propensity to consume not exceeding 60–70%."[15] ("Marginal propensity to consume" refers to the last unit of income — the one on the "margin" — which the consumer receives, and proposes to spend, in this instance at Keynes's estimated 60–70% rate.) In this way his extrapolations argued for a weakness in consumption, but were too obviously biased to merit the uncritical acceptance they met.

Influenced powerfully by Keynes and the late Depression, economists worried extravagantly and uselessly during World War II about the consumption collapse to be expected with the end of war-generated demand. Later, in 1948, the distinguished Harvard economist and future president of the American Economic Association, John H. Williams, noted in "An Appraisal of Keynesian Economics": "Thus far, the forecasts have been almost uniformly bad." Instead of a collapse or even decline, economists had to explain the appearance of a "secular upward drift" in the consumption function. Later work of Kuznets, reported in his paper, "Capital Formation, 1879–1938," saw consumption as a constant fraction of income, but with a moderate tendency in the 1920s for the consumption proportion to *increase*. Similarly, Colin Clark found that saving had been a diminishing fraction of the growing national income in England for at least a generation. Williams concluded, "We have nothing left of this basic concept of the Keynesian theory other than that consumption is an important component of income and deserves all the study we can give it."[16]

Meanwhile, successively newer generations of researchers, careless in their reading of *The General Theory* but true to Keynes's spirit, understood his claim to mean a proportional increase in the propensity to save (or proportional decline in

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the propensity to consume) as aggravated by income inequality. Two early studies, however, tended to deny both the existence of a consumption lag *and* the negative effects of inequality.

The first study promptly led the hopeful research into a dead end. In 1947 Samuel Lubell, a Harvard graduate student and former staff member of the Federal Reserve System, used governmental studies specifically to relate inequality to consumption expenditure in the article "Effects of Redistribution of Income on Consumers' Expenditures." He concluded that "if the present data are correct, too much emphasis should not be placed on income redistribution for the solution of the savings-investment problem." Lubell used data for 1941 that showed persons with annual incomes over $10,000 saving 29% of those incomes, while persons with incomes below $500 were dissaving $87, i.e., spending their savings or borrowing to that extent to maintain a bearable living standard. Positing complete or partial movements to equality, namely 100%, 50%, and 10%, he calculated that the resultant increases would mean 4.1%, 2.4%, or .5% increases, respectively, in all expenditures. Hence, "no redistribution of any feasible severity will bring about a large enough change in any expenditure to offer a major contribution to the problem of increasing the demand."[17] His figures, among other things, inevitably reflected the mathematical commonplace that averaging the income of members of any known society would mean mediocre incomes for each member. Still, if the combination of these research results with an awareness of the statistical limitations deterred some researchers, others rose to the challenge of proving Keynes to have been right.

Keynes had assumed that income as received during a given period under examination was the only significant factor in determining consumption spending: the *absolute income hypothesis.* (This term has nothing to do with the distinction he had made between absolute and proportional increases/decreases in saving/consumption. The researchers assumed that *proportional* increases/decreases in saving/consumption—necessary to generate the consumption lag in Keynes's preferred theory—were *absolutely* determined by income.) Another study, arriving at the *relative income* hypothesis, showed the relation of consumption to income to be much more complex and problematic than that. In his widely cited book, *Income, Saving, and the Theory of Consumer Behavior* (1949), James S. Duesenberry, who was teaching at Harvard, actually saw a "Drive Toward Higher Consumption," as a subheading announced it, because of the "character of our culture," rising living standards, and "habit formation." He went on to see income inequality encouraging rather than reducing consumption because of the "emulation" factor, poorer persons spending more on the example of the wealthier. Duesenberry specifically challenged Keynes's absolute income hypothesis and instead posited consumption and savings as dependent on a series of factors: interest rates, the relation between current and expected income, income- and age distribution, and the rate of income growth. Additionally, he pointed out that according to one set of data, blacks saved three times as much as whites of the corresponding income levels. He reasoned that such blacks were in

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a higher relative position in their own community and felt wealthier than the absolute figures indicated; thus, the relative income hypothesis.[18] If Duesenberry was right in just one or two of these various senses, consumption according to Keynes could hardly serve the operational requirements of his *General Theory*—to produce the promised stagnation in production and employment.

A number of variants of the absolute and relative income hypotheses appeared, the most significant being the Tobin Modification of the relative income conception, with wealth as well as income influencing consumption—to explain blacks' lower spending as due to less wealth; the life-cycle hypothesis of households consuming a constant proportion of their expected lifetime income; Milton Friedman's similar permanent income hypothesis, which placed more emphasis on wealth and shortened a household's planning horizon to three years; and the thesis of "real balance effects," which also emphasized wealth in the form of real net liquid assets encouraging consumption. The result of this theorizing and research was to distance economic thinking from the theory of Keynes which had inspired it. For while the new work produced useful insights about consumer behavior, it made no difference to the validity of Keynes's consumption theory whether Friedman's permanent income hypothesis or the real balance effects of Arthur C. Pigou and Don Patinkin were more nearly correct. If, as all their studies showed, consumption was only partially and perhaps secondarily influenced by unqualified income as compared with other factors, then Keynes's hypothesis was called into question as much by Keynesians like James Tobin and Patinkin as by the non-Keynesians Pigou and Friedman. The point is that the tremendous amount of work invested in strengthening the consumption part of *The General Theory* succeeded in gravely weakening it—or worse.

At various junctures from the 1950s into the 1980s, these and many other research efforts have been reviewed by historically minded economic writers. Some of the later writers themselves attempted to improve upon what they saw as neglected opportunities or failures. In 1959 "The New Theories of the Consumption Function" (the "consumption function" is the mathematical relation of consumption to the factors, e.g., income, wealth, etc., influencing it) noted the fundamental disagreement among interpretations and found major problems in statistical completeness and credibility.[19] In 1962 "Research in Household Behavior" surveyed the field since World War II, emphasized "the need for reconciling the different theories of the consumption function," and concluded, "It is amazing how little attention is being given to the improvement of data collection techniques, and how much empirical analysis is focused on attempting to explain what may be no more than errors of observation."[20]

Similarly, two surveys in the 1970s found inadequate research, more disagreement among researchers, and, in any case, a failure to substantiate Keynes's hypothesis. In 1975 Alan J. Blinder of Princeton, prolific author of many theoretical writings and of a well-regarded Keynesian textbook, declared himself "shocked" to discover that the consensus rejecting Keynes's hypothesis had never been "subjected to a direct empirical test," carried out such a test, and ended by

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supporting that rejection. Indeed, although a representative of mainstream Keynesianism, Blinder had to grant that "equalizing the income distribution will either have no bearing on or (slightly) reduce aggregate consumption."[21] In 1977 Ronald G. Bodkin, a member of the more radical Post-Keynesian school, reviewed all the researches noted here (except Blinder's) and concluded that "the plethora of attempts at empirical verification" had shown that Keynes's consumption function "apparently displayed no such tendency" as attributed to it by Keynes.[22] The negative consensus held.

In 1986 two economists in England noted that "over the past decade the aggregate consumption function in the United Kingdom had been the subject of intensive econometric scrutiny," but that most of that research had assumed Keynes's absolute income hypothesis to be wrong. (Besides the British research, they had reviewed the work of the American, Alan Blinder.) They proposed to rehabilitate Keynes's theory by another approach, radically different in one regard. They refused to limit themselves to past results and instead undertook to base their argument on a computer-constructed projection into the future. Using data on British family expenditures for the years 1963–82, they carried out "simulations experiments" for the period 1983–2000. They achieved the conclusion that by the end of the simulation period a social situation of "more inequality" saved five times as much as "less inequality"—the opposite of the results reported by Blinder, among many others. Thus they could argue that "more equality" would reduce saving and increase consumer spending. But their "experiments" upon the future were protected from any testing against present reality, and, as noted above, were mounted upon the extremely vague classifications of "more inequality" and "less" of the same. Moreover, the priority they granted "social justice" and their stated ambition to create "an instrument of demand management policy"[23] are indications of a powerful left-wing bias that could easily produce the desired results from such a computer simulation.

If one takes a few steps backward to put everything into perspective, one can see a huge fact dominating the history of Keynesian theorizing about consumption and saving: It has remained in the dark tunnel of the psychology of the Great Depression, with its enfeebled consumption, that dominated the writing and conclusions of *The General Theory*. But Keynes himself had escaped from that tunnel by November 1939 when he wrote the newspaper series later published as *How to Pay for the War*; in it he advocated policies to deal with the inflationary effects of wartime prosperity and its *expanding* consumption. Indeed, the Keynes of 1939 had been anticipated by the Keynes of 1919, who wrote *The Economic Consequences of the Peace*. This comparably significant work had a view of consumption and saving totally opposed to that of *The General Theory*, and one that is more relevant to present problems. Keynes had eloquently written then, "If the rich had spent their wealth on their own enjoyment, the world would long ago have found such a regime intolerable." Without limiting such consumption, there could not have been such positive results as the stream of new products from the "immense accumulations of fixed capital." This capital was built up of the savings

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of the "capitalistic classes" who had been allowed to claim most of the benefits of capitalism "on the tacit underlying condition that they consumed very little of [those benefits] in practice."[24] If this represented polemical exaggeration, so did Keynes's consumption theory of *The General Theory* in the opposite sense. A balanced judgment sees consumption as the purpose of the economy and the appropriate savings level as a necessity in providing the materials of consumption.

The Keynesian consensus in economic theory did not pursue Keynes's post-*General Theory* view and, accepting what had become canonical, continued to emphasize the need to strengthen aggregate demand—even after it was long obvious that demand was healthy and growing. It took the inflation of the 1970s to call up "supply side" economics as a way to right the balance. This essentially pragmatic response has not, however, led to a general examination of the origins of the problem in *The General Theory*'s statement on consumption.

It is, after all, increases in saving that make one essential difference between an advanced economy and a less developed one. The New Stone Age, with its exquisitely chipped arrowheads and molded pots, saved more than the Old Stone Age—and much less than the Middle, Victorian, or Space Ages. One should not fear a secular upward drift in saving, which is necessary in order to finance such improvements as arrowheads and computers. Most of the world is wretchedly poor and must save more to improve its condition.

Although such commonplaces must be articulated firmly in the face of the seductions of Keynes's rhetoric of the moment, it should be remembered that Keynes himself knew better than to let himself be imprisoned in any set of ideas, including his own. He fought his way out beyond the consumption theory of *The General Theory,* which must be seen as the time-bound rationale for a policy designed to lead to aggressive and crudely effective actions against the Depression. We have seen that Keynes soon dropped it in his policy recommendations. In *The General Theory* it was, as I have argued, a failure; a half-century of empirical study has not uncovered grounds for reversing this judgment.

NOTES

1. John Maynard Keynes, *The General Theory of Employment, Interest and Money* (London: Macmillan, 1936), 30–1. This has been reprinted (with the same pagination) as vol. 7 of Keynes's *Collected Writings* (hereafter *CW*), ed. Donald Moggridge (London: Macmillan, 1971–83).
2. *Ibid.*, 96–8; in ch. 8, "The Propensity to Consume: I. The Objective Factors," 89–106.
3. Section III ends: ". . . since consumers will spend less than the increase in the aggregate supply price when employment is increased, the increased employment will prove unprofitable, unless there is an increase in investment to fill the gap." *Ibid.*, 98.
4. Besides instances noted in the discussion below, Keynes repeated the thought on the threatening consumption gap in his summarizing ch. 18, "The General

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Theory of Employment Re-Stated," in which weak consumption (248–9) is a major factor in leading to the denouement: ". . . we oscillate . . . round an intermediate position appreciably below full employment and appreciably above the minimum employment a decline below which would endanger life" (254).

5. *Ibid.*, 97.
6. Frank H. Knight, "Unemployment: And Mr. Keynes's Revolution in Economic Theory," in Henry Hazlitt, ed., *The Critics of Keynesian Economics* (New Rochelle, N.Y.: Arlington House, 1977), 77–8. Review published originally in the *Canadian Journal of Economics and Political Science,* Feb. 1937: 100–23.
7. Letters, Arthur C. Pigou to Keynes and response, and Keynes's letter to the other economist, a Mrs. Elizabeth W. Gilboy, as published in the *Quarterly Journal of Economics, CW,* vol. 14, 271–7.
8. Frank H. Knight, "Unemployment," 77–8.
9. *CW,* vol. 14, 275.
10. *The General Theory,* 108–10.
11. *Ibid.*, 105.
12. *Ibid.*, 96–106.
13. Letter, Aug. 30, 1936, *CW,* vol. 14, 84–6; quotation, 85.
14. "The General Theory of Employment," *CW,* vol. 14, 109–23; quotation, 120. The article, in the *Quarterly Journal of Economics* of Feb. 1937, responded to the critiques by Jacob Viner, Dennis H. Robertson, Frank Taussig, and Wassily W. Leontief.
15. *The General Theory,* 127, 128; Keynes's discussion of the figures, 101–4, 127–8.
16. John H. Williams, "An Appraisal of Keynesian Economics," in Hazlitt, 278, 279.
17. Samuel Lubell, "Effects of Redistribution of Income on Consumers' Expenditures," *American Economic Review* 37 (March 1947): 157–70; quotations, 157, 161, 163.
18. James S. Duesenberry, *Income, Saving, and the Theory of Consumer Behavior* (Cambridge, Mass., 1949), 23–6, 45–6, 111–16.
19. M. J. Farrell, "The New Theories of the Consumption Function," in M. G. Mueller, ed., *Readings in Macroeconomics* (London: Holt, Rinehart & Winston, 1969), 77–91. Originally in the *Economic Journal* 69 (December 1959): 678–96.
20. Robert Ferber, "Research in Household Behavior," *American Economic Review* 52, no. 1 (March 1962): 19–63; quotations, 52, 54.
21. Alan J. Blinder, "Distribution Effects and the Aggregate Consumption Function," *Journal of Political Economy* 83 (1975): 447–75; quotations, 448, 472.
22. Ronald G. Bodkin, "Keynesian Econometric Concepts: Consumption Functions, Investment Functions, and 'The' Multiplier," in Sidney Weintraub, ed., *Modern Economic Thought* (Philadelphia: University of Pennsylvania Press, 1977), 69.

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23. V. K. Borooah and D. R. Sharpe, "Aggregate Consumption and the Distribution of Income in the United Kingdom: An Econometric Analysis," *Economic Journal* 96 (June 1986): 449–66; quotations, 449, 463.
24. Keynes, *The Economic Consequences of the Peace* (*CW*, vol. 2 [1971]) (London: Macmillan, 1919), 19–20.

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LETTERS

Western Marxism

TO THE EDITOR:

In her review of my *Western Marxism* ("Western Marxism: A Tale of Woe?," Fall 1988), Sonia Kruks grasps the importance I attach to the difference between a proper assessment of history and a wholesale indictment of modern culture. In my book the former is called "theory of process" and chiefly ascribed to Hegel whereas the latter is dubbed *Kulturkritik* and finds its main spokesman in Nietzsche. My thesis is that while classical Marxism remained as a whole much closer to process theory than to the *kulturkritisch* revulsion against modernity as the child of the Enlightenment, mainstream Western Marxism (WM) did it the other way round, and in so doing generally jeopardized rational standards of thought (though WM as a rule did *not,* as Kruks has me saying, "celebrate" irrationalism).

Now Kruks agrees (119) that I'm correct in denying WM a theory of process but she thinks that WM's "continuing relevance" lies precisely in its "problematizing the notion of progress" through a "nuanced defense and reworking of reason and progress" (125).

Is that an accurate picture of WM "critical theory"? The writings of Adorno & Co. are fraught with statements like this: "Enlightenment is totalitarian" (*Dialectic of Enlightenment*) and "No universal history leads from savagery to humanitarianism, but there is one leading from the slingshot to the megaton bomb" (*Negative Dialectics*). Not surprisingly, even a former member of the Frankfurt school, Joseph Maier, came to point out that in the hands of such Marxists historicism was turned upside down, ending up with a caricature of history as constant retrogression. Level-headed experts on philosophy of history such as Herbert Schnadelbach have argued that the classical Frankfurtian thesis about modernity as the "betrayal of reason" and the height of repression are as little genuinely historical a model of the historical process as Heidegger's

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preposterous indictment of the whole of Western metaphysics since Plato (cf. Schnadelbach, *Philosophy in Germany,* 1984). No wonder many people fail to notice that "nuanced defense" of progress Kruks fancifully reads into WM.

Kruks misconstrues my (hardly original) criticism of Marx's own hostility to the market as tantamount to accepting "the view that modern liberal industrial society is historically divorced from the emergence of capitalism" (121). "We are asked," she writes, "to take it as unproblematically self-evident that there is such an entity as 'the modern economy as such,' analytically and even essentially distinguishable from the historical development of capitalism"—a position, she comments, stemming "from Weber," but "not tenable within a Marxist framework" (120).

One could get Kruks into serious trouble just by requiring her to substantiate her notion that Weber, of all people, severed the modern economy from the history of capitalism. But I prefer to challenge her to show where on earth have I made such a glaring mistake. All I wrote, in a sentence she quotes but wildly misinterprets, is that there was in Marx "an antipathy towards the nature of modern economy as such—apart from any grievances concerning its capitalist social structure" (*Western Marxism,* 52–3). The key word here is of course "social," as it is perfectly possible and legitimate to distinguish the market economy from the transient social structures associated with it. This *distinguo*, however, played no part in Marx's critique of capitalism.

On the other hand, the making of such a distinction in no way entails taking the modern economy for something historically unrelated to the rise and evolution of capitalism; nor has one to be a Marxist to acknowledge it, although the acknowledgement certainly implies recognition of Marx's role in establishing this type of historical connection at a deeper than descriptive level. Besides, how could I, after stressing so much the need for concrete, *specifying,* differentiating historical analysis (which is what the theory of process boils down to)—instead of the massive, indiscriminate historical outlook of *Kulturkritik*—ever dream of indulging in such an ahistorical mode of thinking?

That Kruks, in the age of perestroika, is so patently unable to display the least concern for the institutional autonomy of the economy as a pillar of modernity says much about the historical realism and sociological acumen of the WM constituency in today's academe. The poverty of institutional analysis in WM theory, from Lukács to Marcuse and from Sartre to Habermas (with the glorious exception of Gramsci, the only non-philosopher among them) is impossible to conceal.

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No wonder, therefore, that a defender of the faith overlooks the wealth of determinations going into a reasoned theory of progress and modernity. Accordingly, Kruks saddles me with "naive rational-technological progressivism" just because I don't buy the silly Marcusean denigration of science and technology. Nowhere in my book—nor, for that matter, in any serious work I know of—is the value of modern culture reduced to anything remotely like a crass apotheosis of *die Technik*. This ridiculous idea seems just a curious projection of Kruks's own Frankfurtian demonization of technology.

Still more ludicrous, she accuses me of depicting Hegel himself as an "advocate of reason, *technological progress* and individual freedom" (117; emph. added). She charges me with asserting yet not arguing that Hegel's main value to us nowadays is his legitimation of modernity. This is blatantly unfair, since I happen to devote many a page to *demonstrating* that the Hegel reception, from the romantics to Alfred Marshall and from Kojève to Charles Taylor, always focused on assessing his picture of modern institutions. Assertion instead of argument, sweeping anathemas instead of sustained analyses, are tools of the trade of WM, not of its critics. Significantly, Kruks's footnote list of studies on WM doesn't include one by a single non-Marxist. In view of which, the tribalist self-indulgence with which our post-1968 academic Leftists like to call themselves "non-dogmatic" (117) can be quietly doubted.

José Guilherme Merquior
Paris

Marx as Politician

TO THE EDITOR:

In Paul Thomas's fiercely angry onslaught ("Marx Demythologized or Remythologized?," Fall 1988) on my *Marx as Politician,* there is a sweetly reasonable, praise-crooning review trying to emerge. He might be surprised, like a M. Jourdain enchanted at being informed he has been talking prose, to learn that *he* has been talking in post-Hegelian dialectic and producing unplanned transcendent truths.

In his anger Thomas finds it natural to follow Marxian precedent: attack the person if you cannot cope with the facts and/or argument. The result is a remarkably dense concentrate of the ad hominem. The author under review is successively guilty of a "weakness for . . . hyperbole," "cheap psychologizing," "unguarded moments (which are many)," the kind of response which "would howl us down," "sheer and illegitimate

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reductionism," trying to make a "point [which] is simply beneath contempt," an inability to "deal with *Capital*'s theoretical arguments," "a contradictory interpretation" and "disparate characterizations" of Marx, "confusions [which are] practically encyclopedic," "charlatanry of the worst stripe," and, ultimately, membership amongst "cynics . . . the greatest innocents of all." Felix's conception of politics is limited to a "rather nasty notion of power. . . . It consists in being strong and wilful enough to foist your illusions on to other people, in bamboozling them," indeed "[w]hat is . . . more chilling is the mean and low view of human nature buried in it." In sum, "[i]f nihilism didn't already have a bad name, this book alone would be enough to give it one."

Yet Thomas remarks that my thesis, mounted on "51 pages of scholarly, accurate footnotes" (actually endnotes), is original and "has much to commend it," thus a view of Marx as a "revolutionary politician [whose] theories were always supposed to be geared to practice. . . ." Indeed, there has been a "long overdue need" to examine Marx's "little-interrogated 'revolutionary unity of theory and practice.' " Of course the author was so obtuse as to write his own book and not the reviewer's.

Thomas has blundered into half-articulating my main argument, namely that Marx's politics, the politics of a leader on the order of a Pericles or a Lenin, and expressed equally in his writings and his revolutionary actions, had the colossal effect of depositing in our century Marxian governments ruling more than a third of the world's population, plus a softer socialism as revised suggestively by Eduard Bernstein which has become a considerable force in much of the West—and of exercising an imperial sway over the minds of Western intellectuals and academics like Thomas.

David Felix
Bronx Community College and the Graduate Center,
City University of New York
New York City

PAUL THOMAS *replies:*

David Felix is quite right. I stand duly corrected. I have done him an injustice and am glad to have this opportunity to set the record straight. What I misidentified as footnotes are in fact endnotes, just as he says.

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